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by
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Preface

CCH business law titles are designed to provide a comprehensive yet concise statement of particular important areas of contemporary law. In addition to providing the lawyer and law student with a statement of the principal features of the topic, these titles are also designed to assist business practitioners — the accountant, administrator, banker, manager, marketing executive, etc — and students of business and commerce working and studying in areas with a legal content. *Australian Business Law* takes its place alongside the other CCH business law publications, including loose-leaf, CD-ROM and Internet services, and gathers together in one volume many of the aspects of the law in Australia affecting business.

Updating a book such as this is a continuing process and each edition brings the text up to date to incorporate changes in legislation and case law. All chapters have been revised for this 2001 twentieth annual edition to ensure the continued applicability of *Australian Business Law* to tertiary education syllabuses and to professional readers. The latest materials and cases have been added to Chapter 1 (Introduction), including rewriting of material on the legal system and the legal profession, Chapter 2 (Crime), Chapter 3 (Property), especially intellectual property, and Chapter 4 (Tort in the Business World). The contract chapters have been updated and some material rewritten. Chapter 7 (Consumer Law) and Chapter 8 (Trade Practices) have again been updated in this fast moving area of modern Australian business law, including the latest cases and amendments to the *Trade Practices Act*. All amendments to the Corporations Law relevant to *Australian Business Law* have been worked into the text. All the later chapters including Chapter 14 (Consumer Credit) have had some revision. The development of e-commerce and the legal response has been included in the appropriate pages.

In the interests of accuracy and completeness, the 2001 edition of *Australian Business Law* also contains minor updates to almost every page.

The law is stated as at 1 December 2000.

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About the Author

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Chapter 1

Introduction to Business Law

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¶1-010 What is law? Let us assume you are reading this book in a study or office, home or library. The environment you are occupying is itself as much a legal creation as it is bricks and mortar, timber, steel, glass and plastic. Nearly every detail of the process that has resulted in the building being built is governed by laws in the form of building regulations, municipal permits, town planning orders, etc. These regulations and orders continue to affect the size, shape and quality of rooms, driveways, stairwells, light fittings, doors and windows, not to mention the position of the building on the block of land and the building's power and sewerage facilities. Legally enforceable agreements (contracts) ensure that the building

is serviced by power supply, water and sewerage authorities. Likewise the erection and fittings of the building were all carried out under contracts.

Perhaps you are reading these lines on a bus or train. Its construction and operation are subject to Acts of Parliament governing the laying out and maintenance of permanent ways for railways, the Motor Traffic Acts and Regulations that control road traffic and the many regulations which establish standards to be observed in manufacturing vehicles for use on public roads. Your very presence on a public transport vehicle means you have contracted with the operating authority to be taken from one place to another. This analysis could go on to as many pages as there are in this book if all the laws that govern our daily acts were to be listed in detail.

Business law comprises the laws that determine the rights, duties and obligations of persons involved in business. It maintains balance between the interests of those in business and serves persons as producers and consumers, buyers and sellers, lenders and borrowers. It regulates business transactions, and to do so applies the law of contract (which determines when an agreement will be legally enforceable) as updated by consumer law and trade practices law. It regulates those engaged in business (companies, partnerships, etc), their names, their funding, their banking and their insurance. Some aspects of criminal law (especially property offences) and tort (especially the law of negligence) have an important impact on business.

The law is a body of generally accepted principles established by Parliament (ie by our representatives) and by the courts. Law is therefore made *by* us (the men and women who are parliamentarians and judges) *for* us, is legally enforceable and has developed to set standards of conduct between people, businesses and government. If these standards of conduct are not adhered to, the law provides for resolving the conflicts that arise, and punishing those who breach these standards of conduct.

The law is made up of (§1-180):

- *enacted law*, the law made by Parliament known as statute law, legislation or Acts of Parliament (§1-200—§1-340) and delegated legislation (§1-180); and
- *unenacted law*, the judgments, usually written, of judges in cases heard by them, known as case law: §1-180; §1-350—§1-410.

Together enacted law and unenacted law are often known as the “common law”. But in fact the term “common law” has four possible meanings which depend upon the particular context:¹

- (1) the old meaning: the law common to the whole of England rather than of local application only;
- (2) the unenacted law established by judges in case law decisions (rather than the statute law enacted by Parliament);

1. Glanville Williams, *Learning the Law*, London, Stevens & Sons, 11th ed, 1982, p 25.

- (3) both case law from the common law courts and statute law, as distinct from *equity law* (which had been developed separately from the thirteenth century by the King's Chancellor, and later by the Court of Chancery);
- (4) the law which originally developed in England and later in Australia, New Zealand, most states of the USA, and the other former British colonies, as opposed to "foreign" law of other jurisdictions.

As the common law develops in each jurisdiction, it results in the development of the common law of Australia in the same way that there is the common law of say England or Canada.²

The common law (meaning enacted statute and unenacted case law: (4) above) can be classified as:

- (a) *Civil and criminal law*. Civil law involves matters between person and person regarding the enforcement of rights and the carrying out of obligations. Civil disputes involve most of the business law topics covered in this book which result in remedies for the person winning and liabilities for the person losing. Criminal law includes all statute and case law which declares that certain conduct constitutes an offence. Criminal law is enforced by government (federal or State), and its business application is discussed in Chapter 2.
- (b) *Common law and equity law*. Traditionally the common law only provided a remedy of damages, which might be useless to prevent the occurring of harm or the continuing breach of a contract. As an alternative to the common law courts (which had very rigid pleadings in the early days), equity law developed by direct appeal to the monarch, then the monarch's Chancellor and in time the Court of Chancery.

Equity means the body of rules formulated and administered by the Court of Chancery which supplement common law rules and procedures. The maxims of equity — rules expressing principles of equitable doctrine — include, for example:

- "equity acts *in personam*" (equity acts on the conscience, not the property);
- "equity follows the law";
- "he who seeks equity must do equity";
- "he who comes into equity must come with clean hands";
- "equity aids the vigilant";
- "equity does nothing in vain" (§6-400);
- "where the equities are equal, the first in time prevails" (§3-270);

2. eg *Lipohar v The Queen* (1999) 74 ALJR 282 at p 289: because the federal court system operates nationally, Australia has

a unified common law, not a common law of each State and Territory.

- “equity never wants a trustee” (§9-750ff).

In particular, equity can grant an injunction (§6-410) or an order for specific performance (§6-400) and these are called “equitable remedies”.

Equity law continues and is now fused with the common law, and both systems are administered by the same courts. Equitable principles — eg concerning unconscionability (§5-730) — have made, and continue to make, an important impact on the development of modern business law.

§1-015 The rule of law. Our whole legal system is built on the principle of the rule of law. This is a public law, governmental or constitutional principle which means that laws should conform to a minimum standard of fairness in content and procedure, and that power must be exercised according to law. As formulated by Professor Dicey in the nineteenth century, the rule of law has three aspects:³

- (1) The absolute supremacy of the rule of law excludes arbitrary power. Actions of government in themselves are not the law; official action must be done in accordance with the law. No person can be punished unless there is a breach of the law. Law must be public, published, available and avoid unknown variables.
- (2) All are equal before the law whether private citizen, judge, Prime Minister or government (eg liability in criminal law of public officers: §2-230).
- (3) The rights of citizens are enforceable in the courts (eg trespass, defamation) and these exist independently of any special constitutional safeguards or any Bill of Rights.

§1-020 Law and justice. The principle of the rule of law (§1-015) suggests that law and justice must coincide; but is an unjust law even law? Must an unjust law be obeyed? Can matters of justice or morality or conscience ever take precedence over the law? Indeed, what exactly is the authority of the lawmaker?

One school of legal philosophers, the *Natural Law* school, sees law as derived from above — from a higher law ordained by divine or natural reason. This school sees law as expressing a higher truth and a higher justice than that contained in man-made law. Within this broad group of theories there are enormous variations and refinements, and the tradition stretches down from Plato and Aristotle to the present day.

Christopher Saint-Germain, for instance, writing in 1530, declared that “in every law positive well made is somewhat of the law of reason and of the law of God”, and it is often hard to distinguish between them. He went on to set out the criteria of a good law:

3. Dicey, AV, *Introduction to the Study of the Law of the Constitution*, London, Macmillan, 10th ed, 1964, pp 202-203.

“Also to every good law be required these properties: that is to say, that it be honest, rightwise, possible in itself, and after the custom of the country, convenient for the place and time, necessary, profitable, and also manifest, that it be not captious by any dark sentences, ne mixt with any private wealth, but all made for the commonwealth.”

In contrast, the *Positivists* see law as consisting essentially of the rules imposed by the sovereign power over the sovereign's subjects. The study and the theory of law to the positivist tends to be secular, concentrating on things as they are instead of things as they ought to be. Jeremy Bentham (1748-1832), the father of positivism, claimed that because law is man-made, it can be whatever man chooses to make it. John Austin (1790-1859) was another writer to divorce law from justice, basing law not on ideas of good and bad but on the power of the superior. In modern times, the mantle of Austin as England's positivist theorist fell on HLA Hart, who was Professor of Jurisprudence at Oxford University.

As Professor Hart pointed out, one of the problems with this view of the moral authority of law is that respect for the principles of legality is “unfortunately compatible with very great iniquity”. The legal authority of the German Nazi state in the 1930s and 1940s sanctioned deportations, mass murders and ultimate forms of human degradation. But these actions were “legal” under the legal system then in force. Numerous war criminals were tried after 1945 and the defence of “obeying the law” was raised. There was a clear clash between the positive law (that is, the law which had actually been imposed), often of unprecedented brutality, and the principles of natural law, the elementary ideas of justice. It would have been impossible for the post-war German courts to declare the whole Hitler dictatorship illegal and to treat every decision of Hitler's government as void; but it would have been equally impossible to carry forward the effects of Nazi actions in the name of law. In the upshot many moral principles of humanitarianism were applied by the post-war German courts in cases where spies, informers and other war criminals were punished despite the defence of legality. The laws on which the defence was based were declared to be invalid as contravening basic principles of morality. (What is crime?: ¶2-010.)

¶1-025 Law, morality and society. The areas covered by law and morals are sometimes the same (for example, the moral principle that promises should be kept underlies the law of contract), and while law and morals often overlap, some matters are immoral but not illegal and others are illegal but not immoral. Respecting, observing and obeying the common areas of law and morality is the culture of our community.

Without codes of conduct giving effect to society's underlying ideologies and ways of life, there would be uncertainty. In a pluralist society where values are not universally shared, law plays a crucial role in maintaining social cohesion because it recognises and gives effect to community values,

provides for the settlement of potentially disruptive disputes, and (ideally) provides for the orderly adaptation of rules to social change.

THE LEGAL SYSTEM AND THE ADMINISTRATION OF LAW

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¶1-030 The legal system and personnel. The legal system is the framework in which the law operates. It is created by us, the people, who elect representatives from among ourselves to meet together in Parliament as lawmakers — to pass laws to provide the rules under which society operates. The laws create standards of conduct and courts to provide for their enforcement.

The legal system is built in the culture in which we live and it absorbs the values of the culture. Our culture supports and expects the honouring of contracts, the compensation of injuries, the protection of person and property; it supports the constitutional formula of peace, order and good government (¶1-475).

The legal system “works” when its laws are:

- (1) certain — based on stability and predictability;
- (2) flexible — able to adapt to new situations;
- (3) known — available by being published (¶1-015; ¶1-370), and
- (4) reasonable — having widespread acceptance as fair, just and necessary.

For a legal system to “work”, its laws must be respected, observed, obeyed and the authority of the lawmaker must be respected and supported.

The legal system involves many people:

- *Those who make laws* — the members of the Commonwealth, State and Territory Parliaments (legislators).

The senior law officer of the Parliament is the Attorney-General, who is a Member of Parliament. The Attorney-General and the Attorney-General's Department is responsible for legal policy at the highest level of government. This may include advice to the government which may bring about changes to the law through law reform and the evolution of legislation. The Attorney-General and officers of the Attorney-General's Department may act for the government in legal proceedings, or this may be done by the Solicitor-General or other law enforcement agency.

- *Those who apply the laws* — the judges, tribunal members, magistrates, judicial registrars, registrars and their supporting administrations.
- *Those who enforce the laws* — prosecution can be initiated by authorities such as the DPP (§12-110; §12-140), ACCC (§18-725), ASIC (§19-380), Australian Taxation Office (ATO), National Crime Authority (§12-300) and environment protection authorities. Law enforcement involves corrective agencies (including prisons).
- *Those who advise on the law* — the legal profession (§11-040), Legal Aid Offices, community legal services.
- *Those who administer the law*. In addition to the administrative staff supporting all of the above, the law is administered in such areas as debt collection and process service, and by registration authorities such as those registering companies, land (Land Titles Offices: §13-300), names, patents, trade marks and so on.
- *Those who research, write about and teach the law* — in schools, universities, continuing education, law reform agencies (§11-420), etc.

§11-040 The legal profession. The legal profession includes all those who have passed a professional law course at most Australian universities (usually LLB) or, in addition in New South Wales, the Legal Practitioners Admission Board course. Upon graduation, and generally following an apprenticeship (as an articled clerk, or by taking a short post-graduate professional practice or legal skills course available in most jurisdictions such as that offered by the College of Law in Sydney), a law graduate may be admitted by the court to legal practice — to practise as a barrister *or* solicitor, or as a barrister *and* solicitor (depending on whether the particular jurisdiction has a fused or divided legal profession: see below). Practice as a barrister is preceded by an apprenticeship while “reading” at the bar.

Judges. At the top of the legal profession are the judges, tribunal members, magistrates and registrars who apply the law to make a judgment or decision.

Judges are appointed by the relevant government department, usually on the recommendation of the relevant Bar Council (representing the Bar), generally from the senior ranks of practising barristers. All lawyers are eligible for judicial appointment, and solicitors, law professors and senior public servants have been appointed to the bench.⁴ The independence of the judiciary

4. eg Current issues, *Judicial appointments* (1999) 73 ALJ 609.

is important, and in most jurisdictions this is reinforced by judges' appointment to retirement age or for life.

Barristers and solicitors. The division of the profession into barristers and solicitors follows the English pattern. Solicitors are those practitioners who maintain offices to which the public can go for legal advice on a whole range of matters. They are usually the general practitioners of the law, undertaking work such as conveyancing, drafting wills, administration of estates; giving legal advice to clients; usually acting as intermediary between client and barrister where further specialisation is necessary, and sometimes undertaking court appearances for clients especially in Magistrates' Courts (although a solicitor has a full right of appearance in all courts).

The legal sole traders are the barristers. Prohibited from forming partnerships with other barristers or with solicitors (§10-020), barristers are usually specialists in court-room work, arguing cases in courts and tribunals and advising on the usually more complex legal matters. In New South Wales and Queensland there is legal separation; one cannot be both a barrister and a solicitor. However, in the other States and Territories all lawyers are admitted to practice as barristers *and* solicitors. In fact, however, some lawyers choose to practise only as barristers, so that an independent bar exists in all States and Territories. This means that in effect the situation is much the same as in New South Wales and Queensland where the two groups are legally separate under Act of Parliament.⁵

Because there is either legal separation or a tendency towards de facto separation in all jurisdictions, a member of the public will generally go first to a solicitor's office even though a court or tribunal appearance may be necessary. Some matters may be "sent to counsel" by the solicitor. This means that the solicitor briefs a barrister on behalf of the client (the member of the public). Together they go to the barrister's chambers, where the barrister takes over the conduct of the case on behalf of the barrister's client (the solicitor), who now acts as a kind of intermediary between the member of the public and the barrister. In the past, a barrister could only act for a member of the public on the instructions of a solicitor, but recent pro-competitive reforms in some jurisdictions now allow for direct briefing by the public. Advocacy is the last speciality of the bar, but it faces competition by solicitors, especially if the solicitors' mega-firms continue to develop in-house expertise, research and court appearances as in Canada and the USA.⁶

5. eg *Debate — The divided profession: the case for/the case against* (1990) 64 LIJ 244.

6. The then Trade Practices Commission's final report on the legal profession (March 1994) recommended sweeping pro-competitive reforms to the legal profession for more efficient and

competitively priced services: TPC, *Final report — Study of the professions*, 1994, noted, eg, (1993) 67 ALJ 891; TPC Bulletin, No 75, p 51 (April 1994). Co-advocacy rules in some jurisdictions now allow a barrister to appear jointly with a solicitor advocate: eg *Co-advocacy* (1995) 69 ALJ 315.

Some barristers and/or solicitors work in-house as legal advisers, corporate counsel, compliance officers and as company secretaries.

Legal academics, law reformers, commentators. Significant numbers of lawyers are now engaged in teaching full time, whereas in the past much of the training of students was undertaken by practitioners who also taught part time. There is now the full time legal academic who may never have practised at all. From the ranks of these legal academics may be drawn expert advisers to government and industry in many areas including those that may not fall within the expertise of many legal practitioners. Many academic lawyers are extensively engaged in researching and writing the legal commentaries and textbooks used by and relied on by both the legal and business communities. Indeed, a text-writer's work may assist in the interpretation of a statute or a common law rule, and "[t]he courts of Australia are right to turn to ... textwriters and others for assistance in arriving at a correct interpretation ...".⁷ In other words, academic lawyers and other writers of textbooks, commentaries and legal articles can summarise, distil, confirm and indicate the law for the use of the legal profession. In addition, some academic lawyers are involved in the research and recommendation of law reform proposals, either individually or as consultants to governmental law reform commissions.

Australia's legal profession is changing:

- The legal profession is rapidly moving towards a national practice extending over State and Territory borders with a "travelling" practising certificate. Several jurisdictions already provide for interstate recognition of qualifications.
- Mergers of the larger capital city law firms have resulted in Australian business law now being dominated by a few national law firms which are increasingly developing international links. Legislation is being implemented to allow law firms to incorporate under the Corporations Law, which will allow raising of capital from the public and the limitation of personal liability (cf ¶4-290) but will mean supervision by ASIC (¶9-380).⁸ Less than one-third of solicitors practise in small firms in the suburbs and this number is declining.
- Numbers of lawyers are increasing rapidly, and are expected to increase further.
- The proportion of women in the profession has grown from 0.2% in 1911 to about 30% on current figures, and about half of current law students and staff are female. Only 1.4% of the advocates (barristers or solicitors) appearing before the Full High Court in 1996-1997 were

7. *Day & Dent Constructions Pty Ltd (in liquidation) v North Australian Properties Pty Ltd (provisional liquidator appointed)* (1982) 150 CLR 85, per *Murphy J* at p 111.

8. eg *Legal Profession Amendment (Incorporated Legal Practices) Bill 2000* (NSW).

female. The first Australian full court of three female judges sat in 1999.⁹

- The legal profession was largely involved in private practice until the 1970s, but there are now many lawyers not in legal practice working in related areas such as tax (in accounting firms), insurance, banking (especially merchant banking), administration and elsewhere in the business world. Many lawyers have salaried positions in the public sector (government, Legal Aid Commissions and legal aid schemes: ¶7-760).
- Globalisation of the legal profession is the next step, with local admission of foreign legal practitioners and further development of transnational legal practices and transnational multi-disciplinary partnerships made up of, for example, lawyers and accountants (¶10-020).¹⁰

¶1-060 Hierarchy of courts. Legal matters and legal disputes are heard in a wide variety of courts and tribunals, because of various factors. The court structure provides that the most serious and costly cases (in terms of seriousness of offence or value of money involved) are handled at the highest level by the “superior” courts, while minor offences which can be solved quickly are dealt with in readily accessible “inferior” courts. In between there are the “intermediate” courts.

The hierarchy of courts exists for at least four reasons:

- Geographic factors determine that the 90% of cases which can be called minor are dealt with locally in the readily accessible Magistrates’ Courts.
- Similarly, administrative convenience regarding specialisation and economy of operation determines that cases of a similar nature are tried if possible in similar courts.
- Because there is a hierarchy of courts, each court can to some extent specialise, in terms of facilities and personnel, in certain types of cases.
- Finally, judges and juries (see ¶2-120) may make mistakes, and the hierarchy of courts allows an appeal (¶1-170) to a higher court to have an error of law corrected. This also means that the superior courts supervise the inferior courts.

9. eg Weisbrot, D, *Australian Lawyers*, Longman Cheshire, 1990, Chapter 3; Law Council of Australia, *Equalising Opportunities in the Law Committee, Different Gender, Same Agenda? A forum on equal opportunity in the law*, 1996, available at www.lawcouncil.asn.au under Committees; *An all female full court*

(1999) 73 ALJ 394; *Women in the legal profession* (1999) 73(5) LJ 19; Dixon, F, *The state of the profession*, (1999) 73(12) LJ 75.

10. eg Clark, E and Blay, S, *The internationalisation of legal practice and education* (1999) 73 ALJ 791.

The diversity is compounded by the division of courts and tribunals according to whether they are set up under Commonwealth (federal) legislation or State/Territory legislation.

Proceedings in Australian courts are “adversary” not “inquisitional” in nature: ¶12-110.

¶1-070 Courts of summary jurisdiction. Magistrates’ Courts¹¹ — or Local Courts, Courts of Summary Jurisdiction or Courts of Petty Sessions — are established under Commonwealth, State and Territory Acts to handle small civil and criminal matters. They handle most of the legal disputes going before Australian courts and provide an accessible location¹² for dispute resolution.

In their civil jurisdiction, Magistrates’ Courts cover a wide range of disputes concerned with small debts and other small matters. These small disputes may cover claims arising under contract, claims for compensation for injuries received in car accidents, claims as to title to land, and some family law matters. An important prerequisite is the need to fall within the monetary jurisdictional level.¹³

The criminal jurisdiction of Magistrates’ Courts is of two types.

- (1) There is the procedure where a preliminary hearing is held (“committal proceedings”: ¶12-130) into cases of more serious crime such as murder, theft, corporate crime (such as insider trading) and conspiracy, to determine whether the prosecution has sufficient evidence indicating that the person charged may be guilty and should be remanded for trial. If so, the accused will be sent to a higher court for trial (“committed for trial”) by a judge and jury.
- (2) Magistrates’ Courts deal with summary offences (in contrast to indictable offences) in matters such as police prosecutions for failure to pay fines for traffic offences. These matters are tried “summarily” by the magistrate and are disposed of in summary manner by either the imposition of a fine or a period of imprisonment. Magistrates can generally imprison as well as impose substantial fines.

In addition, a Magistrates’ Court may function as a coroner’s inquest to investigate unexplained deaths and fires. A further jurisdiction of the

11. Generally called Magistrates Courts; also Local Courts or Courts of Petty Sessions in WA. In NSW there have been sittings since 19 February 1788.

12. Castles, AC, *Closing down country courts* 1990) 64 ALJ 583.

13. Vic \$40,000 *Magistrates’ Court Act 1989* sec 3, 100; NSW \$40,000 *Local Courts (Civil Claims) Act 1970* sec 12; Qld \$50,000 *Magistrates Courts Act 1921* sec 4; WA \$25,000 *Local Courts Act 1904*

sec 30-32; SA \$60,000 (motor vehicles: personal injuries and property), \$30,000 (other civil) *Magistrates Court Act 1991* sec 8; Tas \$20,000 *Magistrates Court (Civil Division) Act 1992* sec 3, 7; ACT \$50,000 *Magistrates Court (Civil Jurisdiction) Act 1982* sec 5(1); NT \$100,000 *Magistrates Act 1977* (NT); *Local Court Act 1989* (NT). The Darwin Magistrates Court is responsible for 14 different jurisdictions.

Magistrates' Court is that of the Children's Court (noted at ¶12-210) involving the hearing of all summary and indictable offences (except homicide) committed by persons under the age of 18 years.

In some jurisdictions less formality and greater public access has been introduced to these courts by the introduction of:

- (1) compulsory arbitration for smaller matters, where the magistrate is released from the rigidities of the rules of evidence and the adversary system, can actively seek information, and is bound only by the common sense rules of natural justice; and
- (2) in the case of larger matters over the arbitration limit, pre-hearing conferences conducted by a magistrate or senior court officer to promote settlement of the complaint or at least clarification of the issues to speed up settlement.

The Federal Magistrates Court was established in 2000 with jurisdiction in federal areas such as appeals from administrative decisions, bankruptcy, family law and trade practices (up to \$200,000).

In most jurisdictions, appointments to the position of magistrate are made from the ranks of barristers, solicitors, government and academic lawyers. In some jurisdictions, legally unqualified justices of the peace (JPs) can carry out administrative functions normally performed by magistrates, such as granting bail and issuing search warrants.

¶1-080 Intermediate courts. These courts, called the District Court¹⁴ or County Court,¹⁵ which exist in all jurisdictions except Tasmania, the Northern Territory and the ACT, fall between Magistrates' Courts and the Supreme Court. In practice and procedure there are few differences between these courts and the Supreme Court, and the full range of pre-trial fact finding procedures such as interrogatories and discovery (see ¶1-430) are generally available. Aspects of intermediate courts which differ from the Supreme Court are:

- the upper jurisdictional level, which is in the middle range but extends to the same jurisdiction as the Supreme Court in South Australia.¹⁶
- some restrictions on exercising jurisdiction in equity, admiralty and probate;
- the ability to administer justice quickly and inexpensively generally in less complex litigation, and

14. *District Court Act 1973* (NSW); *District Courts Act 1967* (Qld); *District Court Act 1991* (SA); *District Court of Western Australia Act 1969* (WA).

15. *County Court Act 1958* (Vic).

16. SA *District Court Act 1991* sec 8 (with some limitations); Vic \$200,000 (criminal

jurisdiction) and unlimited jurisdiction in personal injuries cases *County Court Act 1958* sec 37(1)(a); Qld \$250,000 *District Court Act 1967* sec 68; WA \$250,000 *District Court of Western Australia Act 1969* sec 50; NSW \$750,000 *District Court Act 1973* sec 44.

- their presence in non-metropolitan areas.

The criminal jurisdiction covers most indictable offences (ie where there is trial by judge and jury) except capital offences like murder, and other matters reserved for the Supreme Court such as treason and sedition. The intermediate courts also hear appeals from a magistrate sitting in his criminal jurisdiction, and it is often wise to transfer a case from a magistrate to an intermediate court. One reason for this is that whereas Justices of the Peace and magistrates are not always legally qualified, judges of the intermediate courts are appointed from the ranks of experienced legal practitioners. Accordingly these courts are manned by judges sufficiently expert to handle complex cases often with real points of substantive law. Trials may be lengthy and protracted, and, as in the Supreme Court, indictable criminal offences (§12-050) are tried by judge and jury.

§1-090 Supreme Courts. The State Supreme Courts are “superior courts” (cf “inferior courts” §1-060) with unlimited jurisdiction. They have both an original jurisdiction to hear all civil and criminal cases (unless that jurisdiction has been removed by statute, as is true of most divorce matters) and an appellate (appeal) jurisdiction. The civil jurisdiction usually encompasses large and complex cases, and (until the establishment of the Family Court of Australia) divorce and ancillary proceedings. Some civil proceedings are still heard by a judge and a jury. The criminal jurisdiction is made up of a judge and a jury.

In all jurisdictions, appeals on points of law go to intermediate appellate courts usually comprising three appellate judges. In line with the UK, the Canadian provinces and New Zealand, New South Wales (1965), Queensland (1991) and Victoria (1995) have established Courts of Appeal. With the abolition of Privy Council appeals (§1-150), and the restriction of High Court appeals to those of public or general importance, only granted by the court by special leave, other jurisdictions considering the establishment of a Court of Appeal see the benefits as the provision of a permanent appellate court not disrupted by the rostering of judges to trial work, and better able to develop the common law in a principled manner.¹⁷

§1-100 Federal courts. The development of the federal justice system since the mid 1970s — involving the establishment of the Federal Magistrates Court (§1-070), the Federal Court (§1-110), the Family Court, the AAT (§1-160) and the *Administrative Decisions (Judicial Review) Act 1977* (Cth) (§1-165) — has brought about a radical change in the Australian legal system. With the earlier-created Industrial Relations Court, these are superimposed on the three-tier State court system, which originated in the pre-federation Australian colonies.

17. eg Maclean, D, *Victoria — Court of Appeal* (1995) 69 ALJ 881; Young, PW, *175th anniversary* (1999) 73 ALJ 561.

Other federal courts — the courts of the ACT and the Northern Territory — were created to administer justice in these federal Territories.¹⁸

The Australian Constitution, which is the authority for federal courts, solved the question of the relationship of federal and State powers and interpretation of law in a manner different from that other federation, the United States of America. In the USA all questions that arise as a result of federal law — ie law enacted by federal Congress — must be disposed of in federal courts, which are courts set up to deal with federal laws. In Australia the position is more complex.

The federal Constitution empowers Parliament to create federal courts or to invest a State court with federal jurisdiction:¹⁹ in other words, questions arising by virtue of federal laws (for example prosecution for breach of customs regulations) are dealt with in a federal court or in State courts at any of the three tiers.

The Commonwealth and the States designed the former cross-vesting scheme²⁰ in 1988 under which:

- State and Territory Supreme Courts were vested with the civil jurisdiction of the Federal Court and the Family Court (with some exceptions), which therefore allowed the Federal Court and the Family Court to exercise original and appellate jurisdiction with respect to State matters.
- the Supreme Court of another State or Territory was able to exercise original and appellate jurisdiction with respect to State matters. Jurisdiction with respect to criminal matters was not included in the scheme.
- a “special federal matter” such as matters arising under the *Trade Practices Act 1974* (Cth) could be compulsorily transferred by a State Supreme Court to the Federal Court.

The cross-vesting scheme, agreed to by all governments and designed to avoid the inconvenience and the expense of the Australian federal system, was declared invalid in 1999 on Constitutional grounds by the High Court in *Wakim’s case*.²¹

The High Court held that the Commonwealth cross-vesting legislation which intended to confer State jurisdiction on federal courts was invalid under the Constitution:

- Chapter III of the Constitution (“The judicature”), and especially its sec 75, 76 and 77, is an exhaustive statement of Commonwealth judicial power.

18. Constitution sec 71: ¶1-460; ¶1-475.

19. Constitution sec 77(iii).

20. Under the *Jurisdiction of Courts (Cross-vesting) Act 1987* (Cth) and reciprocal State and Northern Territory legislation.

21. *Re Wakim; ex parte McNally* (1999) 73 ALJR 839, per Gummow and Hayne JJ at [122], noted (1999) 73 ALJ 487.

- a State Parliament cannot confer jurisdiction on a federal court. Only the federal Parliament can do this under Constitution sec 77;
- the cross-vesting legislation was not authorised by the Constitution under its “incidental” power (sec 51(xxxix): ¶1-475) or the implied incidental power (sec 71);
- the cross-vesting legislation was invalid in so far as it intended to give the Federal Court jurisdiction to exercise State judicial power;
- the Commonwealth’s power to create federal courts excludes the power to confer other jurisdiction on those courts; and
- where power under the Constitution does not exist, co-operative federalism cannot supply the missing power: “In truth, what is sought to be done by the [cross-vesting] legislation that now is in question is to supplement the power that the Commonwealth is given by the Constitution with respect to the federal judicature, not to complement it.”

As *Wakim’s* case set back the development of a fully integrated system of State and federal adjudication, most jurisdictions passed remedial and retrospective legislation to validate pre-*Wakim* decisions of federal courts while the Commonwealth prepared legislation to deal with the judicial review of decisions made by Commonwealth officers under State laws.²²

Cross-vesting could only be completely restored by an amendment to the Constitution by a national referendum or by a reference of powers by the States to the Commonwealth in certain areas.

Wakim’s case has not marked the end of co-operation between Commonwealth and State/Territory governments: “federalism and co-operation are not inconsistent”.²³

¶1-110 The Federal Court of Australia. The Federal Court of Australia was created in 1976²⁴ to cover areas of Commonwealth jurisdiction such as bankruptcy, federal tax, industrial law, intellectual property and trade practices.²⁵

Full Court of the Federal Court. Appeals can be made to the Full Court of the Federal Court from:

- (1) a single judge of the Federal Court;
- (2) the Supreme Court of the federal Territories in both their civil and criminal jurisdictions;
- (3) the Supreme Courts of the States exercising federal jurisdiction.

The creation of the Federal Court has also eased the work of the High Court by the transfer of certain areas such as taxation appeals, which can

22. eg *Jurisdiction of Courts Legislation Amendment Act 2000* (Cth).

23. *Wakim’s case*, per Gleeson CJ at p 846.

24. Under Constitution sec 71; ¶1-460; ¶1-475.

25. *Federal Court of Australia Act 1976* (Cth). The Federal Court replaced the earlier Federal Court of Bankruptcy and the Australian Industrial Court.

only be taken to the High Court by special leave. In practical terms, judgments of the Federal Court now dominate Australian business law at the expense of the State/Territory Supreme Courts.

¶1-130 The High Court of Australia. The High Court of Australia, consisting of seven justices, was created by the Commonwealth Constitution to serve three purposes:

- (1) to exercise a defined original jurisdiction, ie where matters must commence in the High Court;
- (2) to serve as the final Court of Appeal within the Australian legal system and to hear appeals from State Supreme Courts;
- (3) to act as guardian and interpreter of the Australian Constitution.

The court's original jurisdiction is diverse, and includes indictable offences against the laws of the Commonwealth.²⁶ Exclusive jurisdiction includes matters in which the State and Commonwealth are parties,²⁷ matters involving residents of different States or matters between the States themselves.²⁸ In its appellate jurisdiction the court can hear appeals from single judges of the court,²⁹ with special leave to appeal in cases from State Supreme Courts³⁰ and the Supreme Court of the Northern Territory,³¹ appeals from the Federal Court of Australia in certain cases,³² and appeals from the Family Court of Australia by special leave of the High Court or upon certification of the Full Court of the Family Court.³³

The High Court was well-known for its legalistic interpretations, but some recent decisions indicate a trend towards socially aware and even "radical" decisions in the development of the Australian common law (¶1-010). Examples of the High Court's new approach include the *Tasmanian Dam case*,³⁴ *Mabo's case* (¶1-455; ¶3-425) and the *Burnie case*.³⁵

¶1-140 Family Court of Australia. The Family Court of Australia was established in 1976 to administer the *Family Law Act 1975* (Cth)

26. *Judiciary Act 1903* (Cth) sec 30(c).

27. Constitution sec 75(iii), (iv); *Judiciary Act 1903* (Cth) sec 38(c), (d).

28. Constitution sec 75(iv).

29. *Judiciary Act 1903* (Cth) sec 34 pursuant to Constitution sec 73(i).

30. *Judiciary Act 1903* (Cth) sec 35, 35A.

31. *Judiciary Act 1903* (Cth) sec 35AA.

32. *Federal Court of Australia Act 1976* (Cth) sec 33.

33. *Family Law Act 1975* (Cth) sec 95.

34. Which upheld Commonwealth power to legislate to prohibit the construction of

the proposed Franklin Dam in Tasmania's wilderness area. *Commonwealth of Australia v State of Tasmania* (1983) 158 CLR 1; (1983) 57 ALJR 450; confirmed in *Richardson v Forestry Commission (Tas)* (1988) 164 CLR 261.

35. *Burnie Port Authority v General Jones Pty Ltd* (1994) 68 ALJR 331, in which the court held that the rule in *Rylands v Fletcher* (¶4-090) was now absorbed by the principles of ordinary negligence. See, eg, Solomon, D, *The Political High Court — how the High Court shapes politics*, Sydney, Allen & Unwin, 1999.

following an intensive updating of the then fault-based divorce laws with the introduction of essentially no-fault divorce. From the outset, the Family Court's jurisdiction in the business area was held to include determination of financial relationships between the parties to the marriage and third parties, including such matters as winding up of family companies, partnerships and trusts. This jurisdiction has been further expanded, from 1988, with the *Family Court of Australia (Additional Jurisdiction and Exercise of Powers Act 1988* (Cth) to include transfer to the Family Court of proceedings commenced in the Federal Court relating to bankruptcy, income tax appeals, consumer protection provisions under the *Trade Practices Act 1974* (Cth) and proceedings under the *Administrative Decisions (Judicial Review) Act 1977* (Cth). As from 1988, the Chief Judge of the Family Court is also a justice of the Federal Court of Australia.

¶1-150 Abolition of Privy Council appeals. Until 3 March 1986, the Privy Council in London (described more fully as "The Queen in Council" or "Her Majesty in Council") could hear appeals from State Supreme Courts exercising State jurisdiction where justified by the amount in issue or upon granting of special leave to appeal. The source of this former right of appeal lay in the ancient Crown prerogative (the inherent constitutional power of government) to determine disputes and to create courts of law, and was built upon by the *Judicial Committee Act 1833* (Imp) and the *Judicial Committee Act 1844* (Imp).

Abolition of this residual constitutional link with the United Kingdom had been discussed for years, and had been partly achieved in 1968 (abolition of the right of appeal on matters of federal jurisdiction) and in 1975 (abolition of the right to appeal from the High Court).³⁶

As discussed at ¶1-485, the *Australia Act 1986* (Cth) (amongst other matters) provides that no appeal lies or shall be brought from any decision of an Australian court to Her Majesty in Council whether by leave or by special leave of any court, the Privy Council or by virtue of any Act of the UK Parliament, the Royal Prerogative or otherwise (sec 11).³⁷

Decline of the Privy Council in Australian law. Even before the enactment of the *Australia Act 1986* (Cth), the influence of the Privy Council had been reduced in the Australian judicial system:

(1) Australian law had developed independently for several decades. The one-time view, which gave way in 1963,³⁸ was that the common law of various jurisdictions should remain uniform, and that English decisions

36. *Privy Council (Limitation of Appeals) Act 1968* (Cth); *Privy Council (Appeals from the High Court) Act 1975* (Cth).

37. In particular, sec 11(3) repeals the *Australian Courts Act 1828* (Imp) sec 15, the *Judicial Committee Act 1833* (Imp), the *Judicial Committee Act 1844* (Imp),

the *Australian Constitutions Act 1850* (Imp) sec 28, and the *Colonial Courts of Admiralty Act 1890* (Imp) sec 6 in so far as they were part of the law of the Commonwealth, a State or a Territory.

38. *Parker v The Queen* (1963) 111 CLR 610.

should be preferred to divergent Australian decisions.³⁹ Shortly after the abolition of High Court appeals to the Privy Council in 1975, the Court held that it would no longer consider itself to be bound by pre-1975 decisions of the Privy Council.⁴⁰

(2) The Privy Council itself had ruled that it was not the appropriate body to decide the question of whether a State court was exercising federal jurisdiction, and chose to leave that threshold question to the High Court.⁴¹

¶1-160 Administrative tribunals

Administrative agencies. Set up under the authority of legislation enacted by the Parliament, administrative agencies share the burden of regulation by carrying out their parliamentary-bestowed purpose of administration by the issuing of new “law” called:

- (1) subordinate legislation — or delegated legislation — which takes the form of regulations or by-laws (¶1-180); and
- (2) guidelines, rulings, practice notes, etc designed to fill the interstices in the legislation.

Formal subordinate legislation is to be approved by Cabinet and takes the form of an order-in-council; the less formal practice notes, etc are issued under the authority of the administrative agency itself and may or may not survive challenge in the courts.

Functions of administrative agencies usually include a mix of the three branches of government under the doctrine of the “separation of powers” (the legislature, the executive, the judicature: ¶1-475), namely rule making or legislation; supervision and monitoring; adjudication; advising; investigation and prosecution. ASIC issuing Policy Statements or the Australian Taxation Office issuing Taxation Rulings are examples of the administrator as law-maker. The administrator may be authorised to hold hearings into alleged breaches of “its” law rather than “the” law, thus indicating the need for both impartiality in, and the right to appeal to the court system from, these administrative proceedings.

Tribunals. In addition to the evolution of administrative agencies in the modern business community, the legal system has set up tribunals with specialist expertise.

Specialised tribunals exist to regulate various administrative matters such as:

- (at the federal level) appeals from decisions of federal government

39. *Piro v W Foster & Co Ltd* (1943) 68 CLR 313.

40. *Viro v The Queen* (1978) 141 CLR 88. See further Campbell, EM, *The decline of the jurisdiction of the Judicial Committee of the Privy Council* (1959)

33 ALJ 196; Morley, MG, *The High Court and no Privy Council?* (1979) 53 ALJ 59.

41. *Cadbury Schweppes Pty Ltd v Pub Squash Co Pty Ltd* (1981) 55 ALJR 333; [1980] 2 NSWLR 851 (¶12-030).

Ministers or their departments (such as the Administrative Appeals Tribunal including its tax jurisdiction);

- matters covered by the Australian Competition Tribunal (§8-730), the Australian Conciliation and Arbitration Commission, the Australian Broadcasting Tribunal; and
- (at State level) administrative matters such as planning and land use, preservation of historic buildings, marketing, liquor licensing, censorship, workers' compensation, wages and industrial law.

These tribunals operate like courts although differences between courts and tribunals can be identified as follows:

- (1) In line with the constitutional theory of the separation of powers (§1-475, §1-490), courts (the judicature) are independent of government (the executive) whereas tribunals are in fact a branch of the executive.
- (2) Courts settle disputes between parties as equals, whereas tribunals generally settle disputes between person and government. Tribunals therefore make decisions as an alternative to, or as a review of, an administrative (ie departmental or ministerial) decision.
- (3) Courts are presided over by lawyers while tribunals are often presided over by non-legal experts.
- (4) In contrast to tribunals, courts generally require legal representation of the parties, formal procedures, adherence to the rule of evidence and the doctrine of precedent.
- (5) Courts are a permanent part of the constitution administering a wide body of law, whereas tribunals have a limited jurisdiction.

The following are examples of tribunals:

Administrative Appeals Tribunal. The AAT was established in 1975 to review decisions of Commonwealth Departments and statutory bodies or delegates.⁴² Any person whose interests are affected by an administrative decision can appeal to the AAT,⁴³ the AAT's function being to determine whether a particular decision is the correct and preferable decision on the facts. Its jurisdiction from about 250 different enactments is wide ranging, but mainly involves appeals under the *Customs Act 1901* (Cth), the *Excise Act 1901* (Cth), the *Social Security Act 1991* (Cth), the *Migration Act 1958* (Cth), the *Freedom of Information Act 1982* (Cth), the *Veterans' Entitlements Act 1986* (Cth) (regarding veterans' affairs) and, since 1986, a significant taxation jurisdiction (noted below).

42. *Administrative Appeals Tribunal Act 1975* (Cth); the AAT is paralleled in some jurisdictions for matters within State/Territory jurisdiction such as the New South Wales Administrative Decisions Tribunal established under the *Administrative Decisions Tribunal Act 1997* (NSW); the Victorian Civil and

Administrative Tribunal (1998) and the Administrative Appeals Tribunals established under the *Administrative Appeals Tribunal Act 1989* (SA) and the *Administrative Appeals Tribunal Act 1989* (ACT); *Judicial Review Act 1991* (Qld).

43. *Administrative Appeals Tribunal Act 1975* (Cth) sec 27.

Under the legislation, detailed and clear reasons must be given by the administrative officer whose decision is being appealed against so that an appellant knows the case to be met. Also and significantly, the tribunal has access to government files.⁴⁴ The actual hearing is very similar to a court proceeding except that formalities are reduced as far as possible. The tribunal then has the power to revoke or alter the original decision or substitute a new decision.

Administrative Appeals Tribunal — Taxation Appeals Division. Where the Commissioner has disallowed a taxpayer's objection to an assessment of income tax (including unpaid company tax), the taxpayer may have the Commissioner's decision disallowing the objection reviewed by the Taxation Appeals Division of the AAT. Replacing the Taxation Boards of Review in 1986, the Division inherited substantial tax expertise through the carrying forward of many of the Board members, resources and procedures. Taxation review proceedings can be reasonably informal, taxpayers may represent themselves or be represented by lawyers, tax agents or accountants and, in line with the principle that people's taxation affairs should be kept confidential, proceedings are conducted in private unless the taxpayer requests a public hearing.

Proposed Administrative Review Tribunal. On 28 June 2000 the Federal Attorney-General introduced into Parliament the *Administrative Review Tribunal Bill* which when enacted will establish the Administrative Review Tribunal. The new Tribunal will replace the Administrative Appeals Tribunal and three other merits review tribunals. It will consist of six divisions reflecting the main review jurisdictions of the existing tribunals, including the Commercial and General Division and the Taxation Division. The *Administrative Review Tribunal (Consequential and Transitional Provisions) Bill*, introduced on 12 October 2000, when enacted will amend the Acts that confer jurisdiction on the tribunals that are to be abolished so that the jurisdiction is transferred to the new Administrative Review Tribunal.

Australian Competition Tribunal. Comprising both legal and non-legal members (the latter include economists and business leaders), this tribunal's functions are to hear applications for the review of various decisions of the Australian Competition and Consumer Commission (§8-730).

Crimes or Victims Compensation Tribunal. A victim of a crime may be awarded by the Crimes Compensation Tribunal (or equivalent in each jurisdiction)⁴⁵ compensation for death or injuries (including mental injury) sustained as a result of the commission of an offence by another person or in the course of assisting a police officer. Under the compensation legislation, the victim is usually required to make a claim to the tribunal within a short

44. Ibid, sec 28, 36, 37.

45. eg *Victims Compensation Act 1996* (NSW); *Victims of Crime Assistance Act 1996* (Vic), noted by Fourfouris-Mack, C, *The Victims of Crime Assistance Act 1996* (1997) 71(10) LJ 42; *Criminal*

Injuries Compensation Act 1978 (SA); *1985* (WA); *1976* (Tas) (amended 1994 to require persons convicted to pay a levy to the Crown); *1983* (ACT) "prescribed injury"; *Criminal Offence Victims Act 1995* (Qld); *Crimes Compensation Act 1982* (NT).

time after the commission of the crime, and the victim must be unable to obtain compensation from the offender by civil action. The maximum amount which the tribunal may award is not high (eg \$50,000 in New South Wales, \$60,000 in Victoria and \$10,500 in Tasmania) in marked contrast to British and New Zealand schemes where compensation awarded is similar to that which would be recovered by civil action. In determining the compensation to be awarded, the tribunal is to take into account any other compensation or entitlement paid or payable to the victim, for example at common law (§14-210), under the motor accidents legislation in some jurisdictions (§17-730), or under workers' compensation law (§17-065). Some jurisdictions such as Tasmania prevent recovery for death or injury arising from the use of a motor vehicle, or where workers' compensation is payable.

Other tribunals include the Small Claims Tribunal (§17-690—§17-720); the Commercial Tribunal in some jurisdictions (discussed at §17-730 and in Chapter 14); the Motor Car Traders Committee, the Residential Tenancies Tribunal, and the Motor Accidents Tribunal (all discussed at §17-730).

The broad scope of function of administrative agencies may be to the advantage of business and business regulation so long as checks and balances exist through an appeal system. Litigation challenging an administrative decision generally challenges the validity of the delegation to the agency, or alleges that the agency has exceeded its authority. This judicial review may be initiated by one of the procedures discussed in §1-165 below.⁴⁶

§1-165 Review of administrative decisions. It is the function of administrators and the departments and agencies they work for to administer policy, and it is through a branch of constitutional law called “administrative law” that the activities of administrators may be scrutinised and reviewed by a judge or semi-judicial tribunal. The various agencies of government are concerned with the application, the working out and the practical administration of government policy. The agencies in this context include Ministers and their departments, local authorities, public corporations, boards (eg Board of Education), commissions (eg Police Commission) and the like, that are created to perform particular functions of the government or to carry out particular aspects of government business. Private bodies are also subject to administrative law.

The concept of ministerial responsibility under Australia's Westminster system of government states that every action of a public servant is the action of the Minister, and the Minister is therefore responsible to Parliament for the conduct of that Minister's department. While Ministers are accountable to Parliament individually for the actions of their departments, the Cabinet (all the Ministers) is responsible collectively to the Parliament and to the electorate for the actions of the government. These propositions form the

46. See generally McMillan, J, *Administrative tribunals*, Reform, Issue 76, p 67 (Autumn 2000).

basis of the review of administrative decisions, that review being carried out in accordance with administrative law — which is that body of principles and rules that state and govern the functions and powers of all those public servants and agencies of government; thus this branch of the law deals with the judicial and extra-judicial review of the actions of administrative authorities.

Administrative law is a branch of constitutional law but is concerned more with the subordinate agencies of government and with the application of governmental rules in practice, whereas constitutional law relates to the supreme executive and legislature and with the formation of the general policy of government.

Essentially, administrative law targets the exercise of executive functions by public and private authorities or their officers. It is based on common law principles, with strong federal legislation and legislation in many of the States. Australian administrative law includes the decisions of the administrative agencies and tribunals, the Ombudsman (see below), the activities of the Administrative Review Council, proceedings under the *Administrative Decisions (Judicial Review) Act 1977* (Cth) and freedom of information legislation.¹

The central principle of administrative law is that a public or private authority may not act beyond its powers — it may not act *ultra vires*:

- The dismissal of the Chief Constable of Brighton without a fair hearing was void.²
- An ouster of jurisdiction clause that a compensation determination “shall not be called in question in any court of law” was *ultra vires* and a nullity because it did not protect a determination which was outside jurisdiction.³
- An anti-pollution power to prohibit the emission of air impurities did not entitle the authority to prohibit open fires; the relevant Regulation was invalid as it contravened the Act and went beyond the statutory regulation-making power.⁴

Ultra vires extends from excesses of power to defects of power and misuse of power. It gives rise to important presumptions:

- Parliament does not intend to deny people access to the courts.
- A tax may not be levied without the authority of Parliament.
- The privilege against self-incrimination may not be overridden except by authority of Parliament.
- There is a presumption against retrospective legislation.

1. *Extent of development of administrative law in Australia* (1989) 63 ALJ 655.

2. *Ridge v Baldwin* [1964] AC 40.

3. *Anisminic Ltd v Foreign Compensation Commission* [1969] 2 AC 147; [1969] 1 All ER 208.

4. *Paull v Munday* (1976) 50 ALJR 551.

A person with an administrative complaint has many possible remedies to choose from:

Judicial review at common law. By judicial review of administrative action, a court reviews the legal propriety of the actions of the executive. Judicial review is concerned to establish whether correct procedures were followed and whether the law was correctly interpreted and applied. It is said that because judicial review at common law should not examine the merits of the administrative decision, and because judicial review cannot guarantee a favourable decision to reverse the administrative decision, the common law remedies are inadequate in that they fail to provide for proper review of questions of law or review on the merits of the decision. However, judicial review may indirectly allow the merits of a decision to be reviewed on the grounds of:

- “unreasonableness” — to render a decision *ultra vires* in being so unreasonable that no reasonable person could be expected to have taken it;
- regard to irrelevant considerations or no regard paid to relevant considerations. Case law now tends to place the burden on the administrative decision-maker to show that the decision was based on relevant considerations.

Prerogative remedies. The ancient prerogative writs (originally only available to the Crown) are the:

- writ of *certiorari* — a writ directed by a superior court to remove a matter of a judicial character for better trial, ie a command to “certify”. It “quashes” a decision which is *ultra vires* or affected by error;
- writ of *prohibition* — a writ issued to forbid an act or decision which would be *ultra vires*;
- writ of *mandamus* — a writ of command to compel the performance of a public duty according to law.

Application of the rules of natural justice. A decision-maker must (1) act fairly, in good faith, in a judicial manner and without bias; and (2) give persons affected an opportunity to present their case. The decision may be invalid if it does not fulfil the common law requirement of “procedural fairness”. This includes the need to bring to a person’s attention the basis of the administrative decision so that the person can deal with it in the application. Determining the content of procedural fairness depends on the words of the relevant statute and the circumstances of the case, including the nature of the inquiry, the subject matter, the rules being applied and the interests of the individual as balanced against the “interests and purposes, whether public or private, which the statute seeks to advance or protect or permits to be taken into account as legitimate considerations”.⁵ Procedural fairness includes the

5. *Kioa v West* (1985) 159 CLR 550 at p 585, discussed (1994) 68 ALJ 297.

requirement to balance the interests of all the parties concerned including third parties.

Court declaration. A court can make a binding declaratory judgment to challenge and to test the validity of acts of public authorities.

The issue of an injunction. This equitable remedy (§6-410) has moved into administrative law as an order to stop. Who may apply for an injunction has been interpreted broadly by the courts, especially in public interest cases. The wide-ranging parallel provision in the *Trade Practices Act 1974* (Cth) is discussed at §8-810.

Statutory judicial review. In addition to the above, major reforms to administrative law procedures have been brought about by the following legislation:

- *Administrative Decisions (Judicial Review) Act 1977* (Cth). This Act provides statutory judicial review of Commonwealth administrative decisions. It sets out the entitlement to judicial review of a person aggrieved by a decision covered by the Act, and in so doing limits available remedies. Importantly, it contains a general right to obtain reasons for Commonwealth administrative decisions.
- *Administrative Appeals Tribunal Act 1975* (Cth) (§1-160).

Other administrative law remedies

Publicity and other persuasive pressures, including questions in Parliament (§7-940).

Ombudsman. The Commonwealth and all States and the Northern Territory⁶ have appointed Ombudsmen in recent years, copying a Swedish institution of over 100 years' standing. The basic function of the Ombudsman is to provide a link between citizen and bureaucracy. The Ombudsman receives complaints concerning administrative actions, investigates them, establishes the facts, expresses an opinion and can recommend the appropriate action, thereby calling officialdom to account and increasing its efficiency. However, the Ombudsman has no direct power to direct or to order rectification of a wrong, although pressure can be exerted through publication of opinions and recommendations to Parliament. The purpose of the Ombudsman's investigation is to see if the action complained of is:

- (a) contrary to law,
- (b) unreasonable, unjust, oppressive, or improperly discriminatory,
- (c) in accordance with a defective rule, law, practice, or regulation,
- (d) taken for an improper purpose, based on irrelevant considerations or taken without relevant consideration,
- (e) improperly stated without reasons,

6. *Ombudsman Act 1976* (Cth). See also *Ombudsman Act 1974* (NSW); *Ombudsman Act 1973* (Vic); *Parliamentary Commissioner Act 1974* (Qld); *Ombudsman Act 1972* (SA);

Parliamentary Commissioner Act 1971 (WA); *Ombudsman Act 1978* (Tas); *Ombudsman Act 1989* (ACT); *Ombudsman (Northern Territory) Act 1977* (NT).

- (f) based wholly or partially on a mistake of law or fact, or
- (g) otherwise wrong.⁷

As a go-between, the Ombudsmen have provided an important link between citizen and administration. Building on their track record, two private industry-funded “Ombudsman” schemes have now been set up — for banking complaints (the Australian Banking Industry Ombudsman: ¶16-045), and for insurance complaints (the insurance industry complaints schemes: ¶17-810).

Freedom of Information legislation in the Commonwealth and many jurisdictions gives members of the public rights of access to official government documents.⁸ Access to government information is fundamental in a parliamentary democracy. The theory is that government should have nothing to hide (with the exception of matters of national security, law enforcement, etc).

An appeals system which includes a review of administrative decisions on questions of law is important as providing not only recourse for the individual but also education and guidance for the administration, thereby raising the standard of decision-making. Its object is to make the administration responsive to the interests of the persons affected by it. Australian law has responded in most jurisdictions to these challenges by establishing either an administrative review tribunal of the Supreme Court (eg New South Wales, Western Australia) or an Administrative Appeals Tribunal (eg Commonwealth, Victoria) or equivalent (eg Queensland, Information Commissioner); ¶1-160.

¶1-170 The right of appeal. At the base of the hierarchy of courts and tribunals, as outlined at ¶1-060—¶1-165, is the appeal procedure (see also ¶2-190). An appeal is a legal proceeding taken in a higher court to review the decision of a lower court on the ground that it was erroneous. Appeals generally concern questions of law, not questions of fact, and the appeal judges generally review the law which was applied to the facts by the trial judge in the lower court. In principle, an appeal court should exercise caution in reconsidering the facts, because the trial judge’s assessment of facts involves elements of impression involving imprecision as to emphasis, relative weight, minor qualification and nuance which the trial judge may not have exactly reduced to writing.

— *Example: law v fact* —

Is conduct ‘misleading or deceptive’ in breach of *Trade Practices Act 1974* (Cth) sec 52 (¶7-250)? In the words of the Full Federal Court, “Once the primary facts have been found, the question whether conduct is misleading or deceptive or likely to mislead or deceive is a conclusion of fact. No doubt the question whether conduct is capable of being misleading or deceptive or likely to mislead or deceive would involve a question of law.

7. *Ombudsman Act 1976* (Cth) sec 15(1).

8. *Freedom of Information Act 1982* (Cth); 1989 (NSW); 1982 (Vic); 1992 (Qld); 1991 (SA); 1992 (WA); 1991 (Tas); 1989 (ACT).

It has recently been said by the House of Lords⁹ that even where primary facts are not in dispute an evaluation of facts not depending on assessment of credibility, requires appellate caution in reversing the trial judge's findings."¹⁰

The right of appeal is not necessarily automatic, and there is generally no right of appeal from an order or a judgment of a court unless a right of appeal is expressly provided for; however, since it began in England in the early 1800s, the right of appeal has been sanctified as a fundamental right like free speech, habeas corpus and the right to vote.

Before the early 1800s, there was no right of appeal by the loser at trial. Such procedures as did exist were for groups of trial judges to convene informally to resolve differences in judgments in the interests of some kind of uniformity.

The right of appeal today can involve several layers of courts and hearings, sometimes in addition to proceedings before the court (such as the High Court) to seek leave to appeal. Certainly there are costs and delays and these raise as concerns:

- (1) the time consumed, often several years;¹¹
- (2) the costs to the litigant in preparation of documentation and argument necessary at each level of the appeal process;
- (3) the high costs to the taxpayer in providing the judges and court staff, buildings and facilities;
- (4) the issue of appeal as a weapon not only for the deep pockets of big corporations, but for government prosecutors and government departments such as the Australian Taxation Office, ASIC, the ACCC, etc: "the right of appeal now, in many instances, has an anti-citizen twist".¹²

An appeal court has the same powers as a court of first instance to decide an issue, but it must respect the findings of fact made by the trial judge — who has seen and heard the witnesses. If the trial judge's finding "depends to any substantial degree on the credibility of the witness", the finding must stand unless it can be shown that the trial judge has:

- (1) "failed to use or has palpably misused his advantage", or

9. *Biogen Inc v Medeva plc* (1996) 36 IRP 438 at p 452.

10. *S & I Publishing Pty Ltd v Australian Surf Life Saver Pty Ltd* (1999) ATPR ¶41-667 at p 42,505.

11. But see *Oration by Lord Oliver of Aylmerton* (on judicial administration) (1992) 66 ALJ 695: "It is a depressing truth that the greater the availability and

the greater the efficiency and expedition of appellate procedures, the greater becomes the demand for their deployment. So that, in the end, every improvement tends to become self-defeating and the system chokes on its own success."

12. Estey, J, *The changing role of the judiciary* (1985) 59 LIJ 1070 at p 1081.

- (2) has acted on evidence which was “inconsistent with facts incontrovertibly established by the evidence” or which was “glaringly improbable”.¹³

“Miscarriage of justice” may be another reason for appeal. This is a common law principle which refers to:

- errors in the procedure of a judicial tribunal, such as a serious departure from the rules of judicial procedure; or
- the failure to provide a fair or proper trial (where the relevant law is correctly explained to the jury and where the rules of procedure and evidence are strictly followed), so that the accused lost a chance of acquittal.

However, a material irregularity does not always amount to a miscarriage of justice if the accused did not lose a fair chance of acquittal.¹⁴

SOURCES OF THE LAW

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13. *Devries v Australian National Railways Commission* (1993) 177 CLR 472 at p 479.

14. *Hembury v Chief of the General Staff* (1998) 73 ALJR 1209, per *McHugh J* at pp 1212-1213.

¶1-180 **Where does the law come from?** The sources of our law are the Commonwealth and State or Territory Parliaments, and the courts, based upon legal principle, legal policy and legal authority. These two sources produce respectively enacted and unenacted law.

Enacted law is made by Parliament and is known as statute law, legislation or Acts of Parliament. However, Parliament can and does empower through its statutes other bodies to make laws known as orders, regulations, rules or by-laws. All these are known collectively as delegated legislation. Annually approximately 20,000 pages of legislation and delegated legislation are enacted.

Statute law is said to have the following advantages:

- Statute law takes precedence over case law.
- A statute can communicate simple and carefully phrased instructions.
- Parliament can plan for the future, while unenacted case law decisions look to the past.
- Statutes can be created, amended, etc, whereas case law is in theory bound by the doctrine of precedent (¶1-400).

Delegated legislation. The overwhelming body of legislation that constitutes Australia's enacted law, and which is the main body of law, is delegated legislation. This consists of the regulations of government departments and instrumentalities and the by-laws of local government. The regulations are made by the Governor in Council (or Governor-General in Council) as normal legislation but in reality they are made by the government department or instrumentality concerned. Thus they are enacted without public debate and are often not even tabled in Parliament. This does not mean they are unimportant; rather it underlines the necessity for the possibility of judicial review (¶1-165) of legislation that is not vetted elsewhere. However, the bodies authorised by Parliament to make regulations, by-laws, etc cannot make sovereign laws, because their powers remain subject to the overriding authority of Parliament which can in turn abolish them or restrict their law-making powers.

Arguments in support of delegating powers to pass legislation include:

- (1) Parliament's time is saved for important matters of public concern.
- (2) Regulations relating to technical matters are better left to the specialists in the relevant administrative bodies and departments.
- (3) Flexibility in enactment and the absence of formal parliamentary approval can ensure promptness.

Arguments against delegating powers to pass legislation include:

- (1) Delegation means surrendering legislative power to the unrepresentative and unelected officers of the executive arm of government who are not directly answerable to the electorate.

- (2) Delegated legislation is sometimes inaccessible and contrasts with the proposition that law must be freely accessible.
- (3) Authorities and departments sometimes have overlapping jurisdictions, and their delegated legislation can be inconsistent and unclear.

Unenacted law is made by the courts without direct parliamentary authority. This law, known as the common law or case law (§1-010), originated with the first judges, who were churchmen of the royal court, immediately after the Norman conquest in 1066. At the time there was no Parliament, and the King supported his judges. The body of rules they built up has been added to and modified by Parliament. However, the judges in Australia still have power to interpret enacted law, and thus, although it is accepted that Parliament is supreme, the judges have power to make law (§1-410).

It is a necessary corollary to the power of judges and the nature of the hierarchical court structure in which they sit that there be a doctrine that establishes that similar cases will be decided similarly. This doctrine that lays down that lower courts must follow the decisions of higher ones is known as *precedent*, and it guarantees order in the decisions of the court structure (§1-400).

§1-190 Sources of the law illustrated. It is proposed to illustrate the comments on the sources of the law in §1-180 by examining first a statute (enacted law) — the one chosen, the *Acts Interpretation Act 1901* (Cth) is one of the most important ever passed (§1-200—§1-340) — and secondly a reported court case (unenacted law) — again, one of the most important case law decisions yet handed down (§1-350, §1-360).

§1-200 Sources of the law: (1) statute law — *Acts Interpretation Act*. The *Acts Interpretation Act 1901* (Cth) assists in the interpretation of statutes. There is an equivalent statute in each jurisdiction,¹⁵ and their aim is to assist both the parliamentary draftsman (the person who actually writes the statute) and the reader by providing definitions of commonly used words, commencement dates, etc. Interpretations provided by this legislation must be read in addition to the principles evolved by the courts and discussed below as “Interpretation of Statutes” §1-490—§1-550.

§1-210 Jurisdiction. The *Acts Interpretation Act* is an Act of the Parliament of the Commonwealth of Australia. Acts applying only within the State are passed by State Parliaments. All Parliaments also pass regulations under these Acts. Local government also passes “statutes” in the form of council by-laws (§1-180).

15. *Interpretation Act 1987* (NSW);
Interpretation of Legislation Act 1984
 (Vic); *Acts Interpretation Act 1954* (Qld);
Interpretation Act 1984 (WA);
Acts Interpretation Act 1915 (SA);

Acts Interpretation Act 1931 (Tas);
Interpretation Act 1967 (ACT);
Interpretation Act 1978 (NT); noted also
 at §1-490.

¶1-220 Short title. The short title is only a label identifying the contents of the Act, and is only relevant in statutory interpretation in the case of ambiguity to assist identification of the general purpose of the Act.¹⁶ Indeed, the short title is not always debated by the Parliament. However, there is no clear rule whether the short title can be used to assist statutory interpretation, although in the case of federal and some other legislation, consideration can be so given (¶1-550).

¶1-230 Preamble and objects clause. Legislation sometimes contains a parliamentary statement setting out the reasons for making the Act in question, usually commencing “Whereas ...”. A preamble may, for example, refer to an agreement giving rise to the Act. Similarly, legislation sometimes contains an “objects clause” which sets out the purpose and the objects of the particular legislation. An example of an objects clause is that contained in the *Real Property Act 1886* (SA) sec 10, which sets out the aims of the Torrens system of land ownership (¶3-300). The legal effect of a preamble and an objects clause is similar to that of the long title of an Act.

¶1-240 Long title. The purpose of an Act is often contained in the long title, and legal authorities accept the proposition that the long title may be referred to as an aid in the interpretation of the Act so long as the long title does not contradict clear and unambiguous language contained in the statute.

¶1-250 Enacting words or words of assent. The enacting words generally follow the title and the preamble, and precede the first section of the Act.

“If an Act of Parliament be penned by assent of the King, and of the Lords Spiritual and Temporal, and of the Commons, or, it is enacted by authority of Parliament, it is a good Act ... but if an Act be penned, that the King, with the assent of the Lords, or with the assent of the Commons, it is no Act of Parliament, for three ought to assent to it.”¹⁷

These words also contain a useful reminder of the source of the Act, namely, *ourselves* through our sovereign and our elected representatives. Law is man-made, and is made by us for us.

¶1-260 Headings. As with the long title (¶1-240), the heading must give way to any clear language in the section inconsistent with the heading. Only where the legislation is unclear can the heading be resorted to. However, some interpretation legislation limits this common law presumption by providing that the headings of the Parts, Divisions and Subdivisions into which the Act is divided shall be deemed to be part of the Act¹⁸ and can be considered in the interpretation of the

16. See especially *James v Cowan* (1930) 43 CLR 386 at p 408.

17. *The Prince's case* (1605) 8 Co Rep 13b at p 20b; 77 ER 496, per Lord Coke CJ at p 505.

18. eg *Acts Interpretation Act 1901* (Cth) sec 13(1); *Interpretation of Legislation Act 1984* (Vic) sec 36(1); *Interpretation Act 1984* (WA) sec 32(1).

legislation.¹⁹ In contrast, although the heading to Part V of the *Trade Practices Act 1974* is “Consumer Protection”, case law confirms that the sections in Part V are open, in appropriate circumstances, to any litigant and are not limited to action by a consumer (§17-230).²⁰

§1-270 Sections, subsections and paragraphs. Acts are divided into consecutively numbered sections usually only of one sentence. This is done as a matter of convenience, although these provisions may provide indications for assistance in statutory interpretation in federal and some State/Territory statutes (§1-550). Sections may in turn be divided into numbered subsections, and the subsections into paragraphs (numbered (a), (b), (c), etc) which may in turn be divided into subparagraphs ((i), (ii), (iii), etc).²¹

§1-280 Marginal notes. Sometimes called “sidenotes”, marginal notes give a brief indication or summary of the subject matter of the section. However, they are not usually considered by Parliament and they are generally not to be read as part of the Act.²² Marginal notes often contain legislative history.

In legislation published by commercial publishers, marginal notes are sometimes reproduced in bold type in the first line of the section to which they relate.

§1-290 Definitions. Acts often contain definitions of concepts used in that Act itself. Definitions may be grouped into a section — in the *Corporations Law* this section is called the “Dictionary”.

Section 3 of the *Acts Interpretation Act 1901* (Cth) contains a definition of “commencement” of an Act of Parliament after receiving the assent of the Queen or her representative. This is stated to “mean” the time at which the Act comes into operation; where an Act is expressed to come into operation on a particular day, it “shall come into operation immediately on the expiration of the last preceding day”.

The word “means” is generally used if the definition is intended to be final and exhaustive. The word “includes” is generally used to enlarge the common meaning of the word, such as: “‘paper’ includes ... (a) an ordinance, rule, regulation or by-law; (b) a report; and (c) any other document or instrument whatsoever” (sec 34(2)).

19. eg *Acts Interpretation Act 1901* (Cth) sec 15AB(2)(a); *Interpretation of Legislation Act 1984* (Vic) sec 35(b)(i); *Interpretation Act 1984* (WA) sec 19(2)(a), considered further at §1-550.

20. eg *Concrete Constructions (NSW) Pty Ltd v Nelson* (1990) 169 CLR 594 at pp 601-602; (1990) 64 ALJR 293 at p 294.

21. The *Income Tax Assessment Act 1936* (Cth) gives many examples of the

complexities of numbering: eg sec 124ZAB(6)(b)(ii).

22. eg *Acts Interpretation Act 1901* (Cth) sec 13(3), cf sec 15AB(2)(a); *Interpretation of Legislation Act 1984* (Vic) sec 36(3), cf sec 35(b)(i); *Interpretation Act 1984* (WA) sec 32(2), cf sec 19(2)(a), considered further at §1-550.

¶1-300 **Numbering of statutes.** As well as identification by name, statutes are identified by number.²³ Numbering varies with jurisdictions. The *Acts Interpretation Act 1901* (Cth) was the second Act ever passed by the Commonwealth Parliament, first established in 1901. (No 1 of 1901 was the *Consolidated Revenue Act 1901* (Cth).)

Until 1962,²⁴ Acts of the United Kingdom were cited by reference to the year of the reign, and citations would therefore appear as, eg, “1 Edw 8” (session held in the first year of the reign of King Edward VIII), “c 3” (chapter 3), “s 1” (section 1).²⁵ Since 1857 the Victorian Parliament has numbered all of its Acts consecutively from No 1. Act No 10096 is the *Interpretation of Legislation Act 1984* (Vic).

¶1-310 **Deeming provision.** A deeming provision enables the drafter of legislation to confirm a particular meaning or interpretation. To deem means to count as or to be taken as; sec 13 of the *Acts Interpretation Act 1901* (Cth) deems (confirms) headings and schedules to be part of an Act in contrast to marginal notes and schedules which are deemed not to be part of an Act. At its most extreme a deeming provision could provide what has been described as a statutory fiction by deeming, for the purposes of a particular Act, that white is black.

¶1-320 **Amendments to legislation.** Section 15AA is an amendment to the *Acts Interpretation Act 1901* (Cth) passed by the Commonwealth Parliament in 1981 and inserted into the Act by the *Statute Law Revision Act 1981* (Cth), an Act which came into effect upon receiving the royal assent on 12 June 1981.

The purpose of sec 15AA is to provide new guidelines for the interpretation of Commonwealth laws (¶1-530). These guidelines are aimed at any reader of legislation, whether judicial or otherwise, and provide that attention is to be paid to the purpose or the object of an Act in the interpretation of that Act. This means that a technical, literal and perhaps legalistic approach is to be avoided.

If it is not possible to listen to parliamentary debates in person or on the radio, it is often useful to turn to *Hansard*²⁶ to study the background to legislation, and to learn of the various viewpoints on the legislation which

23. Some Australian States (such as SA) state in Latin at the beginning of the Act of Parliament the year of the reign of the sovereign in which it was passed.

24. *Acts of Parliament Numbering and Citation Act 1962* (UK).

25. *His Majesty's Declaration of Abdication Act 1936* (UK).

26. *Hansard* is subtitled *Parliamentary Debates*, and is the “official report of the proceedings and debates of the Houses of Parliament; colloquially so called as having been compiled for a long period by Messrs Hansard” (*Oxford English Dictionary*). Hansard (who lived from 1752 to 1828) and family descendants compiled the reports until 1889.

were expressed in Parliament. In particular, the Minister responsible for the legislation will usually provide a formal speech of introduction. In the case of sec 15AA, the responsible Minister was the then Attorney-General, Senator Peter Durack QC, and in his Second Reading Speech delivered to the Senate on 27 May 1981 he said:²⁷

“... under our constitutional arrangements it is the function of an independent judiciary to interpret the law and no proposals which we make can or should undermine the freedom that this function requires. Nevertheless the general approach to be adopted to statutory interpretation is something which this Parliament can — and at this stage should — address ...

The effect of the provision to be inserted in the Acts Interpretation Act will be to confirm that in interpreting provisions regard is to be had to the object or purpose underlying the Act in question. I am not among those who would say that the general approach of our courts is at present overly legalistic, but I do think that there is scope for expressly stating that the statutes we make are to be interpreted in a purposive manner. Tax decisions constitute a topical and important example ... but the matter has wider implications that extend to many other statutes.”

¶1-340 Date of commencement. In earlier times (ie from a UK statute of 1793) the law was that a statute operated from the day it received the royal assent, and that is still the general rule in the Australian States.

Acts of the Commonwealth Parliament are in a different position; they are deemed to come into operation 28 days after the royal assent is given.

Both these rules are, however, subject to the overriding power of the Parliament (State or Commonwealth) to provide within the statute itself a date of commencement, which date may be either before or after royal assent. Indeed a Parliament may designate that an Act will commence, after assent, on a date to be proclaimed (ie usually in the *Gazette*).

¶1-350 Sources of the law: (2) case law — *Donoghue v Stevenson*. As explained in ¶1-190, a reported court case will now be examined to provide an example of unenacted law or case law.

Donoghue v Stevenson is the case which clearly established the liability of a manufacturer in the tort of negligence (see ¶4-060) to the ultimate consumer of his product in the absence of any contract between them. This decision changed the law as it then stood, and in so doing laid the foundations for the whole of the modern law of negligence, a law which includes products liability (¶7-206ff), professional negligence (¶4-230ff) and motor accident law.

27. *Parliamentary Debates (Hansard)*, Vol S 90 (Senate), pp 2166-2167, 27 May 1981.

— *Case example* —

On 26 August 1928 at approximately 9 pm Mrs May Donoghue, a shop assistant from Glasgow, and a friend were at Mr Francis Minchella's Wellmeadow Cafe in Paisley, a town 20 kilometres from Glasgow. It was Mrs Donoghue's friend who ordered ice cream and ginger-beer for her; it was Mr Minchella who poured the drink — with its decomposed snail — into the tumbler for Mrs Donoghue. Mrs Donoghue, who suffered severe shock, later gastro-enteritis, mental depression, and loss of wages following time off work, sued the defendant David Stevenson, Aerated-Water Manufacturer of Paisley, for £500 plus interest as damages and £50 costs, alleging negligence. Mr Stevenson's defence was that no reasonable cause of action was disclosed, ie that no law existed to support the plaintiff's claim.

The legal ramifications of Mrs Donoghue's success are discussed at ¶14-060ff.

The case was decided in her favour by a majority of the five members of the House of Lords. In her favour were Lord *Atkin*²⁸ and Lords *Thankerton* and *Macmillan*; against her were Lords *Buckmaster* and *Tomlin*. With her victory in the House of Lords on the preliminary legal point, Mrs Donoghue was in a position to take her case back to the lower court for proof of the facts. Before this was possible, Mr Stevenson died and it is reported that his executor settled the case for £200.²⁹

*Donoghue v Stevenson*³⁰ —

The case, appearing in the English Law Reports in 1932, is extracted in ¶1-360 following, with some analysis of the style and method of law reporting.

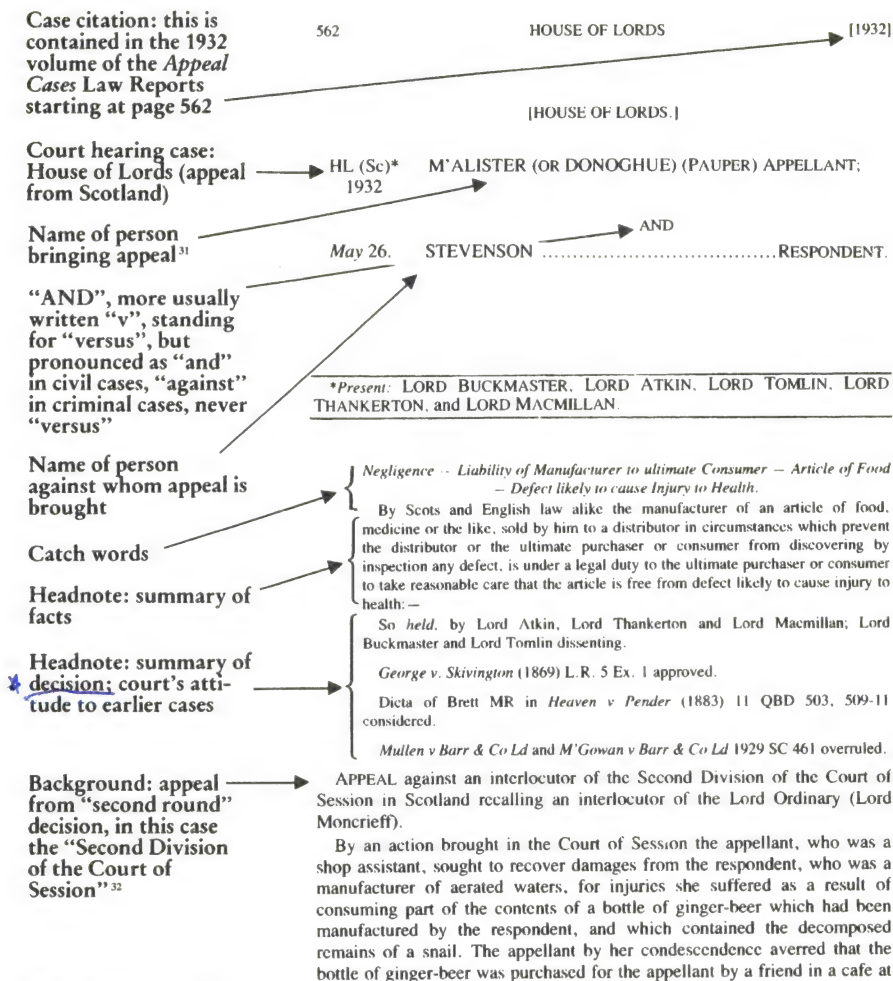
¶1-360 Analysis of a law report. The following extracts are reproduced from the important case of *Donoghue v Stevenson* as an example of unenacted case law and how it is reported.

28. James Richard Atkin was born in Brisbane in 1867. He became a barrister in the UK in 1891, High Court Judge 1913-1919, Lord Justice of Appeal 1919-1928, and was appointed a Lord of Appeal in Ordinary and a Life Peer in 1928. *Donoghue v Stevenson* followed four years later. He died in 1944.

29. *The Good Neighbour on Trial*, *op cit*, pp 65, 72.

30. [1932] AC 562. The 25th anniversary is described in Heuston, RFV, *Donoghue*

v Stevenson in retrospect (1957) 20 MLR 1. Its Golden Jubilee in 1982 is detailed in *The Good Neighbour on Trial*, 17 University of British Columbia Law Review 59-110 (1983). See also Burns, PT, *Donoghue v Stevenson and the modern law of negligence — the Paisley Papers*, Continuing Legal Education Society of British Columbia, 1991, reviewed (1996) 70 ALJ 257. Its 60th birthday is celebrated in Tooher, J, *Still silvery on its diamond jubilee?* (1992) 66 LIJ 379, and *Current topics* (1992) 66 ALJ 615.



31. In Scotland, a married woman does not give up her unmarried name for legal purposes, although she takes her husband's name. In litigation, her unmarried name is placed first, and her married name is given as an alternative. The correct citation of the case is by the married name. Mrs Donoghue, the original plaintiff, is now called the appellant; Stevenson (the original defendant), the respondent. "Pauper" approximates a person suing today with legal aid. To sue *in forma pauperis* meant suing in the form of a pauper without liability for legal costs.

32. This is in effect the Scottish High Court. A decision of a Divisional Court indicates that the Court

comprised two or more judges. The appeal was an appeal from the "first round", the trial judge Lord *Moncrieff*. The background of the case was:

First round: trial judge (Lord *Moncrieff*); Mrs Donoghue (plaintiff) v Stevenson (defendant); judgment for plaintiff.

Second round: appeal to High Court (Court of Session); Stevenson (appellant) v Donoghue (respondent); judgment for appellant Stevenson.

Third round: appeal to House of Lords; Donoghue (appellant) v Stevenson (respondent); judgment for appellant Donoghue.

(p 563) Paisley, which was occupied by one Minchella; that the bottle was made of dark opaque glass and that the appellant had no reason to suspect that it contained anything but pure ginger-beer; that the said Minchella poured some of the ginger-beer out into a tumbler, and that the appellant drank some of the contents of the tumbler; that her friend was then proceeding to pour the remainder of the contents of the bottle into the tumbler when a snail, which was in a state of decomposition, floated out of the bottle; that as a result of the nauseating sight of the snail in such circumstances, and in consequence of the impurities in the ginger-beer which she had already consumed, the appellant suffered from shock and severe gastro-enteritis. (p 564) The appellant further averred that the ginger-beer was manufactured by the respondent to be sold as a drink to the public (including the appellant); that it was bottled by the respondent and labelled by him with a label bearing his name; and that the bottles were thereafter sealed with a metal cap by the respondent. She further averred that it was the duty of the respondent to provide a system of working his business which would not allow snails to get into his ginger-beer bottles, and that it was also his duty to provide an efficient system of inspection of the bottles before the ginger-beer was filled into them, and that he had failed in both these duties and had so caused the accident.

The respondent objected that these averments were irrelevant and insufficient to support the conclusions of the summons.

The Lord Ordinary held that the averments disclosed a good cause of action and allowed a proof.

The Second Division by a majority (the Lord Justice-Clerk, Lord Ormidge, and Lord Anderson; Lord Hunter dissenting) recalled the interlocutor of the Lord Ordinary and dismissed the action.

Arguments of counsel for appellant consumer: not all law reports provide a summary of the arguments of the lawyers appearing in the reported case, yet these arguments often lay the foundation of the court's decision

Precedent: English and Scottish law the same

... yet English authorities are not consistent

Facts in present case are different

Law at date of case required a contract between consumer and manufacturer as basis of liability ... with two exceptions

Arguments of counsel for respondent manufacturer: (p 565) ... rejects a third exception to principle of manufacturer's liability to consumer

1931. Dec 10, 11. *George Morton KC* (with him *WR Milligan*) (both of the Scottish Bar) for the appellant. The facts averred by the appellant in her condescendence disclose a relevant cause of action. In deciding this question against the appellant the Second Division felt themselves bound by their previous decision in *Mullen v Barr & Co Ltd* (1929 SC 461). It was there held that in determining the question of the liability of the manufacturer to the consumer there was no difference between the law of England and the law of Scotland — and this is not now disputed — and that the question fell to be determined according to the English authorities, and the majority of the Court (Lord Hunter dissenting) were of opinion that in England there was a long line of authority opposed to the appellant's contention. The English authorities are not consistent, and the cases relied on by the Court of Session differed essentially in their facts from the present case. No case can be found where in circumstances similar to the present the Court has held that the manufacturer is under no liability to the consumer. The Court below has proceeded on the general principle that in an ordinary case a manufacturer is under no duty to any one with whom he is not in any contractual relation. To this rule there are two well known exceptions: (1.) where the article is dangerous per se, and (2.) where the article is dangerous to the knowledge of the manufacturer, but the appellant submits that the duty owed by a manufacturer to members of the public is not capable of so strict a limitation, and that the question whether a duty arises independently of contract depends upon the circumstances of each particular case.

WG Normand, Solicitor-General for Scotland (with him *JL Clyde* (of the Scottish Bar) and *T Elder Jones* (of the English Bar)) for the respondent. In an ordinary case such as this the manufacturer owes no duty to the consumer apart from contract. Admittedly the case does not come within either of the recognized exceptions to the general rule, but it is sought to introduce into the law a third exception in this particular case — namely, the case of goods

33. The appearance of the Solicitor-General does not indicate government intervention in a public interest case (cf ¶8-810). Until 1946, the Scottish Solicitor-

General retained the right to a private practice: Edwards, J LJ, *The Attorney-General, Politics and the Public Interest*, London, Sweet & Maxwell, 1984, pp 290-292.

- intended for human consumption sold to the public in a form in which investigation is impossible.
- (p 566) *George Morton KC* replied.
The House took time for consideration.
- Judgment** → 1932, May 26. LORD BUCKMASTER (read by LORD TOMLIN).
- Date of judgment (note, date of hearing of appeal, 10 and 11 December 1931)** →
- (p 576) So far, therefore, as the case of *George v Skivington* (LR 5 Ex 1) and the dicta in *Heaven v Pender* (11 QBD 503, 509) are concerned, it is in my opinion better that they should be buried so securely that their perturbed spirits shall no longer vex the law.
- (p 577) The principle of tort lies completely outside the region where such considerations apply, and the duty, if it exists, must extend to every person who, in lawful circumstances, uses the article made. There can be no special duty attaching to the manufacture of food apart from that implied by contract or imposed by statute.
- (p 578) LORD ATKIN. My Lords, the sole question for determination in this case is legal: Do the averments made by the pursuer in her pleading, if true, disclose a cause of action? I need not restate the particular facts.
- Scots for plaintiff** →
- (p 579) I do not think a more important problem has occupied your Lordships in your judicial capacity: important both because of its bearing on public health and because of the practical test which it applies to the system under which it arises.
- The law of both countries appears to be that in order to support an action for damages for negligence the complainant has to show that he has been injured by the breach of a duty owed to him in the circumstances by the defendant to take reasonable care to avoid such injury. In the present case we are not concerned with the breach of the duty; if a duty exists, that would be a question of fact which is sufficiently averred and for present purposes must be assumed. We are solely concerned with the question whether, as a matter of law in the circumstances alleged, the defender owed any duty to the pursuer to take care.
- It is remarkable how difficult it is to find in the English authorities statements of general application defining the relations between parties that give rise to the duty. The Courts are concerned with the particular relations which come before them in actual litigation, and it is sufficient to say whether the duty exists in those circumstances. The result is that the Courts have been engaged upon an elaborate classification of duties as they exist in respect of property, whether real or personal, with further divisions as to ownership, occupation or control, and distinctions based on the particular relations of the one side or the other, whether manufacturer, salesman or landlord, customer, tenant, stranger, and so on. In this way it can be ascertained at any time whether the law recognizes a duty, but only where the case can be referred to some particular species which has been examined and classified. And yet the duty which is common to all the cases where liability is established must logically be based upon some element common to the cases where it is found to exist. To seek a complete logical definition of the general principle is probably to go beyond the function of the judge, for the more general the definition the more likely it is to omit essentials or to introduce non-essentials. The attempt was made by Brett MR in *Heaven v Pender* (11 QBD 503, 509), in a definition to which I will later refer. As framed, it was demonstrably too wide, though it appears to me, if properly limited, to be capable of affording a valuable practical guide.
- (p 580)
- At present I content myself with pointing out that in English law there must be, and is, some general conception of relations giving rise to a duty of care, of which the particular cases found in the books are but instances. The liability for negligence, whether you style it such or treat it as in other systems as a species of "culpa", is no doubt based upon a general public sentiment of moral wrongdoing for which the offender must pay. But acts or omissions which any moral code would censure cannot in a practical world be treated so as to give a right to every person injured by them to demand relief. In this way rules of law arise which limit the range of complainants and the extent of their remedy. The rule that you are to love your neighbour

becomes in law, you must not injure your neighbour; and the lawyer's question, Who is my neighbour? receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be — persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question. This appears to me to be the doctrine of *Heaven v Pender* (11 QBD 503, 509).

(p 599) My Lords, if your Lordships accept the view that this pleading discloses a relevant cause of action you will be affirming the proposition that by Scots and English law alike a manufacturer of products, which he sells in such a form as to show that he intends them to reach the ultimate consumer in the form in which they left him with no reasonable possibility of intermediate examination, and with the knowledge that the absence of reasonable care in the preparation or putting up of the products will result in an injury to the consumer's life or property, owes a duty to the consumer to take that reasonable care.

It is a proposition which I venture to say no one in Scotland or England who was not a lawyer would for one moment doubt. It will be an advantage to make it clear that the law in this matter, as in most others, is in accordance with sound common sense. I think that this appeal should be allowed.

LORD TOMLIN. My Lords, I have had an opportunity of considering the opinion (which I have already read) prepared by my noble and learned friend, Lord Buckmaster. As the reasoning of that opinion and the conclusions reached therein accord in every respect with my own views, I propose to say only a few words.

First, I think that if the appellant is to succeed it must be upon the proposition that every manufacturer or repairer of any article is under a duty to every one who may thereafter legitimately use the article to exercise due care in the manufacture or repair. It is logically impossible to stop short of this point. There can be no distinction between food and any other article. Moreover, the fact that an article of food is sent out in a sealed container can have no relevancy on the question of duty; it is only a factor which may render it easier to bring negligence home to the manufacturer.

(p 600) I am unable to explain how the cases of dangerous articles can have been treated as "exceptions" if the appellant's contention is well founded. Upon the view which I take of the matter the reported cases — some directly, others impliedly — negative the existence as part of the common law of England of any principle affording support to the appellant's claim, and therefore there is, in my opinion, no material from which it is legitimate for your Lordships' House to deduce such a principle.

(p 601)

Order of the court →

Interlocutor of the Second Division of the Court of Session in Scotland reversed and interlocutor of the Lord Ordinary restored. Cause remitted back to the Court of Session in Scotland to do therein as shall be just and consistent with this judgment. The respondent to pay to the appellant the costs of the action in the Inner House and also the costs incurred by her in respect of the appeal to this House, such last mentioned costs to be taxed in the manner usual when the appellant sues in forma pauperis.

Lords' Journals, May 26, 1932.

Agents for the appellant: *Horne & Horner, for WG Leechman & Co, Glasgow and Edinburgh.*

Solicitors — London agents for Glasgow and Edinburgh principals →

Agents for the respondent: *Lawrence Jones & Co, for Niven, Macniven & Co, Glasgow, and Macpherson & Mackay, WS, Edinburgh.*

¶1-370 **Reporting law cases.** Law is made up of enacted law (statutes) and unenacted law (judgments or cases). One aspect of the rule of law is that all people are equal before the law. To help achieve this, the law must be available, accessible and subject to informed public scrutiny.

Judgments could not make law if they were unknown, and it is the system of court reporting which has contributed to the development of law-making by judges. Law reporting in the common law system began in England with the *Year Books* (written in “law-French” — see ¶3-040), commencing in the fourteenth century. These were followed by the *nominate reports*, series of reports published privately by judges,³⁴ barristers³⁵ and other writers,³⁶ and were in turn superseded by semi-official or “authorised” Law Reports in the UK in 1865 published by the (UK) Incorporated Council of Law Reporting.

Early Australian reports were similarly published privately (such as those of Legge in New South Wales,³⁷ 1825-1865, which were a compilation of reports published in the *Sydney Morning Herald*, or those of Wyatt and Webb in Victoria,³⁸ 1861-1863) before the commencement of authorised or semi-authorised reports in the 1860s (eg Queensland Supreme Court Reports, 1860-1881; South Australian Law Reports, from 1865).

There are now numerous series of Australian law reports. These include the authorised reports of the various courts by the Incorporated Councils of Law Reporting, which are published either by the Council itself or by a commercial publisher on behalf of the Council.³⁹ Commercial publishers such as CCH Australia Limited also publish other series of law reports, and there is also at least one private reporter publishing law reports. Increasingly, law reporting is published electronically with Internet and CD-ROM reports, statutes and databases.⁴⁰

¶1-380 **The *ratio decidendi*/proposition of a case.** The *ratio decidendi* (Latin for “the reason (or ground) of a judicial decision”) is the proposition advanced in a case which makes the case a precedent for the future. Formulation of the *ratio* is not always an easy task. It will usually involve:

- separating the unimportant facts from the important facts;

34. eg Coke’s Reports (1572-1616); during the latter period Coke was Attorney-General and then Chief Justice of the Common Pleas and King’s Bench; Blackstone’s Reports (1746-1780), published posthumously.

35. eg Charles Ambler, one of His Majesty’s Counsel-at-law and Attorney-General to the Queen (1737-1784).

36. eg John Dickens (covering 1559-1798) at one time Registrar of the Court of Chancery.

37. J Gordon Legge, barrister-at-law.

38. Alfred Wyatt and George Webb, barristers-at-law.

39. eg *The danger of relying on unauthorised law reports* (1998) 72 ALJ 498 (incorrect word in WLR removed in revision published in the authorised reports (AC)).

40. eg “High quality law reporting is the building block on which the common law depends”: Current issues, *Law reporting* (2000) 74 ALJ 415.

- determining which precedents were applied and which were overlooked or overruled;
- reading the case in the light of interpretations of the case in later decisions.

Determining the *ratio decidendi* may be further complicated if no reasons were given, or if differing reasons were given, or if the important facts were not separated from the unimportant. Furthermore, how far can one generalise from one decision?

For example, what exactly did *Donoghue v Stevenson* (¶14-080) decide? Is it only a case about snails? drinks? drink manufacturers? manufacturers? retailers? or any person in a relationship with any other person requiring the exercise of a duty of care? Professor Julius Stone QC raised the following problems in determining the actual *ratio decidendi* of this case:⁴¹

“The assumption that ‘the material facts’ will thus yield only one *ratio* would imply, if true, that there is only one set of such ‘material facts’ which is to be related to the holding. And this immediately confronts the theory with a main difficulty. This is that, apart from any explicit or implicit assertion of materiality by the precedent court, there will always be more than one, and indeed many, competing versions of ‘the material facts’; and there will therefore not be merely one but many *rationes*, any of which will explain the holding on those facts, and no one of which therefore is strictly *necessary* to explain it. For apart from any selection by the precedent court, all the logical possibilities remain open; and in the logician’s sense it is possible to draw as many general propositions from a given decision (each of which will ‘explain’ it) as there are possible combinations of distinguishable facts in it. It is in these terms that, it has been said, the question — What single principle does a particular case establish? is ‘strictly nonsensical, that is, inherently incapable of being answered’.

If the *ratio* of a case is deemed to turn on the facts in relation to the holding, and nine fact-elements (a)-(i) are to be found in the report, there may (so far as logical possibilities are concerned) be as many rival *rationes decidendi* as there are possible combinations of distinguishable facts in it. What is more, each of these fact-elements is usually itself capable of being stated at various levels of generality, all of which embrace ‘the fact’ in question in the precedent decision, but each of which may yield a different result in the different fact-situation of a later case. The range of fact-elements of *Donoghue v Stevenson*, standing alone, might be oversimplified into a list somewhat as follows, each fact being itself stated at alternative levels.

- (a) *Fact as to the Agent of Harm*. Dead snails, or any snails, or any noxious physical foreign body, or any noxious foreign element, physical or not, or any noxious element.
- (b) *Fact as to Vehicle of Harm*. An opaque bottle of ginger-beer, or an opaque bottle of beverage, or any bottle of beverage, or any container of commodities for

41. Stone, J, *Legal System and Lawyers' Reasonings*, Sydney, Maitland Publications Pty Ltd, 1968, pp 269-270.

human consumption, or any container of any chattels for human use, or any chattel whatsoever, or any thing (including land or buildings).

(c) *Fact as to Defendant's Identity*. A manufacturer of goods nationally distributed through dispersed retailers, or any manufacturer, or any person working on the object for reward, or any person working on the object, or anyone dealing with the object.

(d) *Fact as to Potential Danger from Vehicle of Harm*. Object likely to become dangerous by negligence, or whether or not so.

(e) *Fact as to Injury to Plaintiff*. Physical personal injury, or nervous or physical personal injury, or any injury.

(f) *Fact as to Plaintiff's Identity*. A Scots widow, or a Scotswoman, or a woman, or any adult, or any human being, or any legal person.

(g) *Fact as to Plaintiff's Relation to Vehicle of Harm*. Donee of purchaser from retailer who bought directly from the defendant, or the purchaser from such retailer, or the purchaser from anyone, or any person related to such purchaser or donee, or other person, or any person into whose hands the object rightfully comes, or any person into whose hands it comes at all.

(h) *Fact as to Discoverability of Agent of Harm*. The noxious element being not discoverable by inspection of any intermediate party, or not so discoverable without destroying the saleability of the commodity, or not so discoverable by any such party who had a duty to inspect, or not so discoverable by any such party who could reasonably be expected by the defendant to inspect, or not discoverable by any such party who could reasonably be expected by the court or a jury to inspect.

(i) *Fact as to Time of Litigation*. The facts complained of were litigated in 1932, or any time before 1932, or at any time."

¶1-390 ***Obiter dicta/non-binding observations of a case.*** In addition to the *ratio decidendi*, the judgment may contain observations or statements of less force than the actual ruling of the case. These are known as *obiter dicta* (sayings by the way), often abbreviated as "dicta". A judge can hypothesise by way of dicta, and can also raise examples and comparisons by way of dicta. Because dicta are observations, they are not binding as precedent. The views of the members of the House of Lords in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*⁴² (¶4-240) on the existence of liability for negligent advice were expressed *obiter* because the disclaimer clause in that case prevented liability from actually being imposed on the bank which gave the negligent advice in question. This announcement by the judges *obiter* that liability would extend to negligent advice in the right circumstances was applied three years later.⁴³

The *obiter* of Denning LJ (in dissent) in the forerunner to *Hedley Byrne* has become the battle cry for the judicial law reformer:⁴⁴

42. [1964] AC 465; [1963] 2 All ER 575.

43. *WB Anderson & Sons Ltd v Rhodes (Liverpool) Ltd* [1967] 2 All ER 850.

44. *Candler v Crane, Christmas & Co* [1951] 2 KB 164 at p 178; ¶4-240.

“This argument about the novelty of the action does not appeal to me in the least. It has been put forward in all the great cases which have been milestones of progress in our law, and it has always, or nearly always, been rejected. If you read the great cases ... you will find that in each of them the judges were divided in opinion. On the one side there were the timorous souls who were fearful of allowing a new cause of action. On the other side there were the bold spirits who were ready to allow it if justice so required. It was fortunate for the common law that the progressive view prevailed.”

¶1-400 Legal cases as precedents. A precedent is a previous case used as an example for later cases. In law, a precedent (the *ratio decidendi* of a previous case decision) will be used as an authority for deciding a later legal case involving a similar set of facts. Similarly, precedents are used in daily life as examples upon which to model letters, set out accounts, reports, etc.

However, unlike the use of precedents as models in daily life, a judge who does not apply a relevant precedent is legally “wrong” and the judge’s decision can be *reversed* on appeal. A decision not following precedent can be *overruled* if and when it is considered at a later time by a court of the same or higher status in the court hierarchy (¶1-060ff).

An appeal which raises the correctness of a precedent may lead to the precedent being modified — ie clarified, confined or refined — due to further argument and analysis, developments in other courts or fresh approaches to the issue in hand.⁴⁵

If no relevant change has occurred in the circumstances, such as a change in community values, the precedent will continue to be binding on courts at the same level until reversed, overruled or modified by that court, a higher court or by legislation.

A court lower in the court hierarchy is bound to follow a precedent yet may strongly *disapprove* of the decision.

This is not to suggest that the law is stagnant and unchanging. Some precedents fade over time, otherwise the law would be “bound to the morality and culture of a past age.”⁴⁶ Precedents can be *distinguished* or limited in application to perhaps the identical facts. A later court could have limited *Donoghue v Stevenson*⁴⁷ to facts only involving snails in ginger-beer bottles, rather than applying it to the wider variety of circumstances to which it has been applied. As Sir George Paton put it:

“... [i]f the decision is felt to be wrong, the principle will be confined to cases raising precisely the same issue; if it is thought correct, the merest *obiter dictum* may have very great weight.”⁴⁸

45. eg *Commissioner of Taxation v Ryan* (2000) 74 ALJR 471 at p 479; [2000] HCA 4 at [42]-[43], per Kirby J.

46. Young, Justice, Current issues, *The aging of precedent* (1997) 71 ALJ 483 at p 484.

47. [1932] AC 562; ¶1-350, ¶1-360, ¶4-080.

48. Paton, GW and Derham, DP, *A Textbook of Jurisprudence*, Oxford, 4th ed, 1972,

This indicates that precedents may be binding or persuasive. A *binding* precedent is the *ratio* of a case decided by a court of a higher level in the court hierarchy. The Federal Court of Australia, for example, is bound by decisions of the High Court. On the other hand, a *persuasive* precedent does not bind the court but can influence its decision. Decisions of courts in other jurisdictions, including those in the Commonwealth of Nations, the US⁴⁹ and Europe find their way into Australian law in this way, but are not binding precedents in Australia. In the words of Kirby J:⁵⁰

“I was insistent that the Court should look beyond the traditional English sources of judge-made law. In an early case I tried this out on Mr RP Meagher QC, telling him that I had seen relevant authority in a recent decision of the Supreme Court of Iowa. His immortal response was: ‘Your Honour is such a tease.’ But nothing is stable in this uncertain world. He has been known of late to cite international human rights norms in support of his opinions. I am now patiently waiting for him to use feminist legal theory to overrule Lord Eldon.”

¶1-410 Law-making by judges. Because of the separation of powers in the Constitution among the legislature (eg Commonwealth Constitution sec 1), the executive (sec 61) and the judiciary (sec 71) (¶1-475; ¶1-490), constitutional theory dictates that Parliament should make law while the judiciary interprets the law as made by Parliament. It is sometimes theorised that judges do not make law—they merely “state” it—but this theory is clearly disproved by the lawmaking that took place in *Donoghue v Stevenson*.⁵¹

The High Court recognises that judges as well as Parliament make law:⁵²

“The argument that judicial alteration of judge-made law is usurpation of Parliament’s role is untenable. The fiction that ‘the common law has never changed but is only declared by the judges’ (see Blackstone, ‘Commentaries

p 220; *Principles governing the High Court’s power to overrule prior decisions* (1987) 61 ALJ 762; *Techniques in the distinguishing of precedents* (1988) 62 ALJ 191.

49. eg *United States Supreme Court case-law examined by High Court* (1990) 64 ALJ 312.

50. Kirby, P. *Farewell speech*, Court of Appeal, 2 February 1996, reported (1996)

70 ALJ 271 at p 272; Dwyer, P, *A roving judicial eye — broader use of foreign judgments by the High Court of Australia*, Reform, Vol 70, p 11, Summer 1997.

51. [1932] AC 562.

52. *State Government Insurance Commission (SA) v Trigwell* (1978) 142 CLR 617; (1979) 53 ALJR 656, per Murphy J at CLR p 650; ALJR p 668.

on the Laws of England', vol 1, 15th ed 1809, pp 68-69) and that what might appear to be alterations are only corrections of judicial misunderstanding of the common law is a notion which should not be regarded seriously. As long ago as Bracton, it was accepted that the growth of English law through judicial decisions was inevitable ... Sir Francis Bacon in *The Advancement of Learning* (1605), recognized that law grew consciously through cases decided by the judges. Bentham violently criticized Blackstone's notion ... and Austin justly characterized it as 'the childish fiction, employed by our judges, that judiciary or common law is not made by them, but is a miraculous something made by nobody, existing I suppose from eternity and merely declared from time to time by the judges ...'.

Some have accepted Blackstone's 'fiction' as a fundamental proposition. But he admitted, and this is sometimes overlooked, that a judge in a common law system may rightly refuse to follow a precedent which is absurd, contrary to reason, or plainly inconvenient ... The virtue of the common law is that it can be adapted day by day through an inductive process which will achieve a coherent body of law. The legislatures have traditionally left the evolution of large areas in tort, contract and other branches of the law to the judiciary on the assumption that judges will discharge their responsibility by adapting the law to social conditions. It is when judges fail to do this that Parliament has to intervene. The extreme case is where the judiciary recognizes that a rule adopted by its predecessors was either unjust or has become so and yet still maintains it, suggesting that the legislature should correct it. This is the nadir of the judicial process. The results of legislative intervention often produce difficulties ... because legislation does not fit easily with 'the seamless fabric of the common law'.

Before *Donoghue v Stevenson*, there were many areas in which it could have been said that it was 'settled' law that there was no liability in negligence. ... In 1932, *Donoghue v Stevenson* unsettled them all. ... *Donoghue v Stevenson* itself, which established the products liability of manufacturers, is a prime example of reversal without Act of Parliament of 'settled' common law."

¶1-420 Sources of the law: (3) Law Reform Commissions, inquiries, reports.

A new law or a change to the law may result from a recommendation following research by a government Law Reform Commission. Established in 1975, the Australian Law Reform Commission, formerly chaired by Justice Michael Kirby, has been responsible for many new laws in areas such as criminal investigation, privacy, sentencing of federal offenders and, of special importance in Australian business law, manufacturers' liability (¶17-215), representative actions (¶17-780), insolvency (¶13-558) and insurance (¶17-035). Equally important is the work of Law Reform Commissions in the two Territories and in most States in updating State/Territory laws. Law Reform Commissions in Australia are very active, and their work is detailed in the periodical *Reform* published by the ALRC.

Royal Commissions, parliamentary committees, review committees, inquiries and the like often lead to new laws and procedures. There are many

examples of new laws in the business law area resulting from the work of committees, eg the Senate Committee on the national companies scheme (1987: ¶19-370), the Rae Committee on a national stock exchange (1974: ¶13-400), the Manning Committee on cheques (1964: ¶16-020, ¶16-190), the Campbell Committee on the Australian financial system (1981: ¶16-020) and the Griffiths Committee on insider trading (1989) (to name but a few). The Companies and Securities Law Review Committee (1984-1990: ¶9-380), which was replaced in 1991 by the Companies and Securities Advisory Committee, researched many difficult areas and was responsible for some important changes to the law.

These commissions and committees usually hold hearings and consult widely in the process of changing and reforming the law. Their work stimulates the democratic process of law-making and law reform, and in so doing leads to further important demystification of the law.⁵³

LEGAL PROCEDURE

Using the courts	¶1-425
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¶1-425 Using the courts. Courts and tribunals are open to any person whose claim is within their jurisdiction but only a few disputes go to court:

“The cost and delays involved in the litigation process are notorious. Fortunately, only a small proportion of proceedings commenced actually go to trial and judgment. The great majority is settled one way or the other. As a general principle fair and appropriate settlements are encouraged to reduce the burden of litigation on both public and private resources. Courts are frequently asked to play their part by accepting formal undertakings or making orders by consent which prohibit parties from certain conduct or require them to do certain things. Sometimes they are asked to impose agreed pecuniary penalties. In carrying out those functions, Courts are conscious of the public interest in the settlement of cases. They must also be conscious, however, that the laws they apply are public laws. It is in the public interest that, in considering agreements between parties requiring orders of a Court, the Court does not act as a mere rubber stamp. What is proposed must always be scrutinised to determine whether undertakings or

53. eg Handford, P, *The changing face of law reform* (1999) 73 ALJ 503.

consent orders are within power and are appropriate. There is sometimes a tension between these components of the public interest”¹

Costs may be a deterrent to enforcement of legal rights for some individuals, but legal aid (§7-760), Australia’s modified contingency fee system (§7-765) and class actions (§7-770—§7-780) provide some access to the law. In civil proceedings, action is taken by the plaintiff against the defendant; in criminal proceedings, the Crown on behalf of the State prosecutes a person called the accused or the defendant. On appeal, the appellant appeals to a higher court against the respondent.

¶1-430 Civil procedure. In civil proceedings the object is to recompense the plaintiff for some act or omission on the part of the defendant, not to punish the guilty.

A civil action is commenced by the issue of a writ, summons, or statement of claim (eg NSW). This document addressed to the other party (the defendant) calls on the defendant to appear, in the court from which the writ is issued, to answer the case of the plaintiff. In jurisdictions where the writ is the usual initiating process it will generally include the plaintiff’s statement of claim, which states in general the plaintiff’s case. Failure on the part of the defendant to respond to the writ or other initiating process leads to an order being made against the defendant. As the object of the proceedings is to cure the plaintiff’s complaint, failure of the defendant to respond is not the concern of the system. Indeed this can lead to a speedier conclusion to the matter by means of a default judgment.

The document initiating proceedings must be “served” on the defendant, which means that a copy is handed to the defendant personally, or a copy may be left at the defendant’s home, business, etc with a responsible person. Alternatively, service may be more indirect, such as service by registered mail, or newspaper advertisement, or service on the defendant’s solicitor. This is called “substituted service”.

In response to the writ and statement of claim the defendant replies with a defence, a document formally answering the points raised by the plaintiff. The defence can take one of three forms to each point raised by the plaintiff:

- (1) to *traverse* is to deny a material fact;
- * (2) to *confess and avoid* is to confess (ie admit) the truth of an allegation of fact, but to avoid it (ie deprive it of effect) by alleging new matter by way of justification; and
- (3) to *object to a point of law* is to say that even if the facts the plaintiff relies upon are true they give the plaintiff no legal remedy.

1. *ACCC v Real Estate Institute of Western Australia Inc* (1999) ATPR ¶41-673, per French J at p 42,599.

After the general grounds of dispute between the parties have been ascertained, the procedure of discovery enables each party to establish the details of the other side's case.

Civil procedure is characterised by extensive pre-trial pleadings, ie the exchange of documents between parties, which also goes on the court record, designed to clarify the facts in dispute and thus speed the trial itself.

Interrogatories are numbered questions on issues of fact delivered by one party to the other which must be answered on oath. They are designed to obtain admission of fact in order that the areas in dispute be known before the trial. Thus each party will know what the other disputes — the answers on oath are binding on the parties and are produced in evidence at the hearing.

Discovery or revealing of documents enables one party to compel the other party to furnish a list of the documents in his possession or power relating to the matters in dispute. After seeing this list the party discovering can demand that any of the documents be produced. The only documents that are excepted as a matter of course are those that constitute communications between a party and his legal adviser.

Finally the parties can, by a formal device called the *admission*, admit the truth of the whole or any part of the other side's case or admit any specific fact or document. At this stage the pre-trial procedure or pleadings are concluded and the matter can proceed to trial.

As more details are revealed during the pleading, the parties acquire a more realistic idea of their cases' respective points, and of the likelihood of an out-of-court settlement. In the out-of-court settlement the plaintiff is still recompensed for the defendant's act or omission and the court is thus free to deal with more intractable disputes. Incentives to settle at the "door of the court" include avoiding the uncertainty of the continuation of proceedings, and avoiding further expense, time, and possible problems of proof.

Outcomes in civil cases may involve:

- (1) an award of damages (monetary compensation), for example in tort (¶4-175ff) or for breach of contract (¶6-380ff);
- (2) an injunction, an equitable order to stop (eg ¶6-410, ¶8-810);
- (3) an order for specific performance (an equitable order forcing completion (¶6-400)).

¶1-435 Debt recovery. There are many legal ways of recovering payment of debts, even though some debtors manage to avoid them some of the time. Some entrepreneurs unscrupulously use legal technicalities to walk away from business failures and leave small investors and creditors unpaid.

Debt recovery can be a difficult process. Debt recovery law tries to strike a balance between the rights of the creditor to payment, and the rights of the debtor to basic civil liberties. On the one hand, the creditor is entitled to be paid. On the other hand, debtors have rights including protection from dishonest, misleading or harassing tactics by debt collectors (such as continuing

calls about the debt, and their impersonating police officers and carrying weapons).²

Methods used to encourage punctual payment of debts. An efficient credit control policy is the best means of ensuring punctual payment of debts. This includes periodic statements of the account and prompt reminder notices. The debtor should not be allowed to fall into arrears. If there are delays in payment, the creditor should contact the debtor. If the debtor has problems with payment, it is sensible to talk through the problems and arrive at some arrangement rather than allowing the situation to deteriorate.

The creditor could offer incentives to prompt payment, such as discounts for punctual payment and default interest for late payment (so long as the interest is not unenforceable as a “penalty”: ¶6-490).

Credit should not be extended without proper assessment of the risk. Applications for credit should be carefully examined for evidence of a satisfactory credit history and assessment of the applicant’s ability to pay.

How payment is obtained. Once a creditor is satisfied that there is a bad debt, the debt recovery process starts with the creditor sending a letter of demand to the debtor (personally, or through an agent such as a solicitor or debt collection agency). The letter of demand gives details of the amount due and what it is for, and demands that the debtor pay the debt. (The creditor may ask for its legal costs for recovery as well.) The letter states that if the amount is not paid within the time specified, legal action will be commenced without further notice.

In response to the creditor’s letter of demand, the debtor may:

- pay. If the debtor does pay in response to the letter of demand, the debtor only has to pay the amount of the debt and cannot be forced to pay the creditor’s legal costs.
- enter a scheme of arrangement with the creditor. A creditor may prefer to accept a scheme of arrangement instead of risking further costs by taking legal action. If the creditor goes to court, the creditor may lose and be ordered to pay the debtor’s legal costs. For example, in court the creditor may not be able to prove the existence of the contract giving rise to the debt if the contract is an oral one.
- settle. This may be the result of a conference between creditor and debtor to sort out the issues. Settlement may be brought about by mediation or arbitration (¶1-441—¶1-444).
- dispute the debt and go to court. (The jurisdictions of the courts are set out at ¶1-060ff.) In some jurisdictions, small debts are arbitrated.

2. “Undue harassment” is prohibited by the *Trade Practices Act 1974* (Cth) sec 60; *Fair Trading Act 1987* (NSW) sec 55; 1999

(Vic) sec 21; 1987 (SA) sec 69; 1987 (WA) sec 23; 1989 (Qld) sec 50; 1990 (Tas) sec 26; 1992 (ACT) sec 26; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 55; ¶7-460.

How judgment is obtained and enforced

(1) *Preparation of summons.* Court proceedings start with a written claim. The claim has different names in different courts in the various jurisdictions and may be called a “Statement of claim” or a “Summons” or a “Writ”. It must be served within six years of the debt, or it will be statute barred under the Statutes of Limitation (§16-500). The claim must state the case — the facts and the whole history of the debt — and must be clear.

The creditor pays stamp duty and filing fees for the claim, and its own legal fees.

(2) *Court summons.* The court then issues a summons, and the creditor and debtor become respectively the plaintiff or claimant and the defendant. The summons may be:

- an ordinary summons. This orders the debtor to appear in court to answer a claim for a liquidated (specified) or unliquidated (unspecified) claim.
- a special summons. This saves time by requiring evidence from the defendant of a liquidated or unliquidated claim (such as under contract) by affidavit (a sworn statement) instead of requiring the defendant to appear in court. If the defendant does not reply, liability is admitted.
- a default summons. A default summons is for a debt of a liquidated amount. It states that the plaintiff can obtain judgment by default without a court hearing unless the defendant enters a defence.

(3) *Service.* The creditor (or its representative) serves the claim on the debtor personally, with a copy to the court, and the debtor has a certain number of days (say 28) in which to lodge a defence. An “Affidavit of service” is then lodged with the court.

(4) *Defence.* Most debtors do not defend a claim for debt, but if the debtor does dispute the claim, the debtor may lodge a defence. Sometimes the defence is used as a tactic to “buy” time to pay the debt. The defence must specifically answer and deny each of the allegations in the claim.

The debtor may have a case against the creditor, for example for breach of contract. By a defence and counter-claim, the debtor may counter-claim against the creditor.

Sometimes the parties may serve interrogatories (questions) on each other and/or they may apply for discovery of documents in the possession of the other. These court processes must be answered.

(5) *Judgment.* Judgment may be obtained:

- by default. If no defence is entered within the time allowed on the claim, the creditor enters judgment by default. In the lower courts, this is signed over the counter, and the creditor gets an award of costs. In higher courts, the creditor may need an affidavit attached to the claim to support the default judgment and outlining the fact that the debt has not been paid.
- by hearing in open court.

Processes to enforce judgment. Once a court has handed down a judgment in favour of the creditor, the debtor may still refuse to pay. Many judgment debtors pay without delay, but some still need encouragement to pay. The creditor may then have to enforce the judgment against the debtor.

Unsatisfied legal judgments may be enforced by solicitors, debt collectors and commercial agents (§11-380), and can form grounds for bankruptcy (§13-590). There are many ways in which to enforce an unpaid judgment:

- *Examination process or examination summons or oral examination.* This requires the debtor to attend court to be questioned on assets and income. The court examines the evidence, and will normally make an order, but not if the debtor is insolvent.
- *Instalment order.* The creditor, the debtor or the court may approve payment of the judgment debt (and costs and interest) by instalments. A court will not approve an instalment order if the debtor cannot pay the interest owing.
- *Writ of execution (a warrant).* This is a court order addressed to a court official called the sheriff, to auction the debtor's goods. The sheriff's staff wear uniforms resembling those of police, but they have no authority to enter the debtor's premises unless allowed in. Sometimes they bluff their way in. They "red tag" goods to be auctioned, and formally require the debtor to pay within a certain period such as 14 days. If the debtor does not pay, the sheriff returns (there is a right of re-entry), collects the goods and puts them to auction. The sheriff takes from the auction proceeds the amount of the judgment debt and interest, and gives the surplus proceeds to the creditor. Certain goods, such as tools and furniture, cannot be taken by the sheriff. There are two types of writ of execution:
 - *A writ over land*, and
 - *A writ of execution over goods — ie a writ of fieri facias or fi fa or distress* — which allows seizure of personal property.

A uniformed sheriff serving a writ of execution over goods may shock the debtor into paying, but a writ may not lead to an auction of goods because of issues such as difficulty of entry, doubts over ownership of goods and delays in the legal process. The creditor must pre-pay auction and storage costs. An auction will not go ahead if the debtor files an application to pay by instalments (above). In addition, the debtor may disappear or the goods may be lost or "stolen".

- *Garnishee order.* The creditor may get a court order called a garnishee order addressed to a third person, such as the debtor's employer or bank, to pay to the creditor funds due to the debtor (excluding salary or wages until actually due to be paid). The order means notifying the third person of the debt, to the possible detriment of the debtor's reputation. Complying with a garnishee order also imposes burdens on the third person.

- *Charging order*, issued against annuities, funds, shares or deposits of money in the debtor's name.
- *Writ of delivery and writ of sequestration*, directed to the sheriff to recover from the debtor property other than land or money (delivery) and keep it (sequestration) until the obligation is satisfied.
- *Committal*—imprisonment, such as for contempt of court for disobeying one of the above orders or for not appearing for oral examination.
- *Bankruptcy/winding up*, ultimate weapons discussed respectively at ¶13-558ff and ¶9-600ff.

Many of these means of debt recovery are of ancient origin, and some are rarely used.³

¶1-440 Criminal procedure. In a criminal trial, as discussed at ¶2-110ff, the object of the proceedings is to determine whether the defendant is guilty and, if so, to punish the defendant. This prime object is hedged in by competing concerns, most notably the liberty of the subject from arbitrary interference by law enforcement authorities.

In civil proceedings, the object of curing the plaintiff's complaint is not hindered — and may be helped — by the defendant's failure to respond. However, with a criminal process the defendant must be available to stand trial, to show that justice is being done and to avoid errors — ie wrongful conviction — due to the lack of a defence.

Criminal proceedings do not have the pre-trial fact finding process characteristic of civil procedure, and the cases of the prosecution and the defence are only fully known at the end of the trial. (There is one partial exception to this, however, in the case of indictable offences, where by virtue of the committal or preliminary hearing the prosecution case is heard in some detail before trial.) The criminal process is discussed at ¶2-010ff.

¶1-441 Alternative dispute resolution. Australian business practitioners and their advisers are exploring methods of "alternative dispute resolution" (ADR) — consensual solutions arrived at by the parties themselves with the assistance of a third party. The Alternative Dispute Resolution Association of Australia has defined ADR as meaning "dispute resolution by processes:

- (a) which encourage disputants to reach their own solution and
- (b) in which the primary role of the third party neutral is to facilitate the disputants to do so".

Such methods include negotiation, independent expert appraisal and mediation, and seek to avoid the costs and delays which characterise court proceedings.

3. See further Kercher, B, *Australian Debt Recovery Law*, Federation Press, 1990; Rickards, M, *Pay up! Judgment enforcement — the need for reform*, LIJ,

Vol 70, No 6, p 57 (June 1996), and follow-up letter, LIJ, Vol 70, No 8, p 6 (August 1996).

(Technically, arbitration (§1-443) is not included in ADR as it involves an adjudicative process with a decision arrived at not by the parties themselves but by an arbitrator.) Judges, almost entirely selected from among Queen's Counsel, do not always have the qualifications or resources to deal with disputes involving complex technical, economic, environmental, medical or scientific problems which in any case may be unsuitable for traditional court-room adjudication. The growth of tribunals provides one response, alternative dispute resolution the other.

Compromise, settlement or negotiation out of court. Based on the application of established legal principles, the parties to a dispute may agree to settle: one party agrees to pay or perform in return for an agreement by the other party to cease actual or threatened legal proceedings or to put aside actual or claimed legal rights arising from the dispute. Compromise and the desire to avoid trouble is almost instinctive, and may well be reinforced by the economics of avoiding potentially expensive litigation. Litigation may lead to damaging publicity and negative effects on business and customer goodwill.

§1-442 Mediation. Failure of the parties to a dispute to settle may lead them to seek the assistance of an impartial third party — such as a mediator or conciliator — to bring about a satisfactory result. Mediation is a process directed to enabling the parties to resolve their dispute by agreement. There is no decision as such; this non-arbitral mediation process encourages the parties to reach their own solution and may not involve the application of rules. In comparison with arbitration, the parties have not agreed in advance to accept the decision of the mediator. For example, in some jurisdictions a judge at any stage of court proceedings may order that the proceedings be referred to a mediator (or to an arbitrator) with or without the consent of the parties to try to reach settlement.⁴ A building contract may refer any dispute to the architect in charge of the project. In some jurisdictions there are neighbourhood mediation centres to deal with local basically non-commercial or non-criminal matters, and mediation and arbitration procedure is progressively being introduced into some court procedures.

Although the proceedings may be informal, there is a basic requirement that conciliators or mediators should act fairly and be neutral.⁵ If mediation fails, the parties may then turn to formal arbitration, and failing that, to litigation before a court or tribunal.

§1-443 Commercial arbitration. Arbitration — third-party determination with a binding decision — is the process of referring a dispute to an arbitrator as a private judge to make a decision which the parties have

4. eg the *Courts Legislation Amendment Act 1995* (Qld) allows litigants to participate in ADR processes within the court system.

5. eg Boulle, L, *Mediation — principles, process, practice*, Butterworths, 1996;

Arendsen, N, Guerra, E and Vial, R, *Calming troubled waters — some observations on mediation* LIJ, Vol 71, No 4, p 51 (April 1997).

agreed to accept as binding upon them and final.⁶ Within Australia, only disputes which can be tried civilly can be referred to arbitration, such as those arising from building contracts, partnership contracts and insurance contracts or under statute (compulsory arbitration clauses are ineffective under modern insurance law: ¶17-800).

The purpose of an arbitration is to obtain finality and an enforceable award at the same time as avoiding the costs, delays and formalities of the court system. In addition, a dispute involving complicated technical or commercial problems may be handled more knowledgeably by an arbitrator who is an expert in the area, such as a QC, engineer, architect, accountant or other specialist. The Institute of Arbitrators and Mediators Australia, Law Societies/Law Institutes, and some universities provide training and qualifications in the law and practice of arbitration.

The submission or the agreement to arbitrate may be contained in an agreement between the parties to arbitrate an existing dispute. The agreement does not require mutual or bilateral terms of reference.⁷ It may consist of the parties' agreement as a term of their contract to refer present or future differences to arbitration. The courts will generally enforce agreements to negotiate in good faith in alternative dispute resolution.⁸ Or the parties can turn to the arbitration legislation which provides a mechanism for the appointment of an arbitrator.

Under the Rules of Court, a judge may refer questions of fact and specific questions out to arbitration by a *special referee* such as a builder, computer consultant or engineer to report back to the court. The judge or the parties may nominate the special referee, but the judge retains control over the proceedings because when the report is returned the judge may accept it or reject it wholly or in part. The special referee procedure has the benefit of letting courts deal with the law, while issues of fact are decided by the special referee. However, the special referee procedure assumes that questions of law and fact can be separated and put before different tribunals; this is not always the case, as a specialist tribunal without legal capacity and ability is at the same disadvantage as a court without specialist knowledge of the facts. The large number of such referrals to special referees, and their

6. Arbitration is regulated within Australia by essentially uniform legislation in each jurisdiction: *Commercial Arbitration Act 1984* (NSW); 1984 (Vic); 1990 (Qld); 1986 (SA); 1985 (WA); 1986 (Tas); 1985 (NT); 1986 (ACT). International arbitrations and the enforcement of foreign awards are regulated by the *International Arbitration Act 1974* (Cth). With the enactment of the *International Arbitration Amendment Act 1989* (Cth), Australia became a potential centre of international arbitration by being

the fifth country to adopt the UNCITRAL Model Law on International Commercial Arbitrations as adopted by the United Nations Committee on International Trade Law in 1985.

7. *PMT Partners Pty Ltd (in liq) v Australian National Parks & Wildlife Service* (1995) 69 ALJR 829.

8. Spencer, D, *The good faith element in alternative dispute resolution*, LSJ, Vol 38, No 5, p 58 (June 2000).

success, has had a major effect in reducing delays in the civil jurisdiction of the courts.

Commercial arbitration legislation goes back many years, and was substantially updated with essentially uniform commercial arbitration legislation in 1984-1990. In general terms the legislation provides:

- Reference shall be to a single arbitrator unless otherwise agreed by the parties.
- The arbitrator shall be jointly appointed by the parties to the agreement.
- The possibility for court intervention is kept to a minimum, but in particular the court may appoint an arbitrator or arbitrators where the arbitration agreement is silent or where the appointed person dies or otherwise ceases or fails to act (sec 10-13).
- The power to appoint an arbitrator includes the power to appoint a replacement arbitrator.
- If an even number of arbitrators is appointed, they may appoint an umpire who may enter on the arbitration in the event of deadlock or failure by the arbitrators to determine the matter.
- The Supreme Court has primary jurisdiction in matters related to commercial arbitration, although in an arbitration agreement the parties may nominate the intermediate court (§1-080) as having jurisdiction in relation to disputes arising out of that particular agreement (sec 4).
- The arbitrator has a wide discretion as to the manner in which arbitrations are conducted (sec 14), although proceedings must be according to law. Confidentiality is not an essential part of private arbitration unless there is express contractual agreement. Such agreement may not be effective where an arbitration deals with a significant public interest issue.⁹
- Any person (including the parties to the agreement) must attend for examination, answer questions, and if called for produce documents.
- Witnesses must attend personally, may with the leave of the arbitrator be legally represented, and are examined on oath or affirmation.
- Any question arising for determination is determined according to law unless otherwise agreed between the parties (sec 22(1)); if the parties so agree, the arbitrator may determine any question that arises by reference to considerations of natural justice and fairness (sec 22(2)).
- The arbitrator or umpire may make an interim award (sec 23) (overcoming the expense caused under the old law by having to proceed right through an arbitration to arrive at a final award).
- The arbitrator or umpire has the same power as the Supreme Court to

9. *Esso Australia Resources Ltd v Plowman*
(1995) 69 ALJR 404.

order equitable relief including specific performance of any contract (¶6-400) unless the arbitration agreement provides otherwise (sec 24). A “sec 52” dispute on misleading or deceptive conduct under the *Trade Practices Act 1974* (Cth) (¶7-250 — ¶7-281) may be settled by the arbitrator, including remedies under the Act such as the return of goods (under sec 87: ¶8-860), subject to the reference to arbitration being sufficiently wide in its terms.¹⁰

- The arbitrator or umpire also has the power to order the parties to a dispute to take steps to achieve a settlement without proceeding to arbitration (sec 27). This is a widely used provision in the practical day-to-day management of arbitrations and it has been instrumental in resolving many disputes.
- Awards made in arbitration proceedings are final and binding on the parties to the agreement, unless the arbitration agreement or legislation provides otherwise (sec 28).
- The arbitrator or umpire has the power to award costs and usually interest (especially if there is an interest clause in the contract). The interest component takes into account commercial rates, and recognises the need for the law to operate in a commercially realistic manner (sec 31).
- An arbitrator has a discretion regarding ordering payment of costs, unless the arbitration agreement provides otherwise (sec 34), but normally costs will be awarded to the successful party.
- The court may determine any question of law arising in the course of the arbitration on application by any of the parties to the arbitration with the consent of all the parties or the arbitrator (sec 39).
- The parties to an arbitration agreement may agree in writing to exclude the right of appeal under sec 38 or the right to refer a question of law to the court under sec 39. However, such an exclusion agreement has no effect if the arbitration relates to a dispute arising out of a contract of insurance, unless either the exclusion agreement is entered into after the relevant arbitration commences or the arbitration concerns a contract which is expressed to be governed by a law other than the law of the originating jurisdiction (sec 41).
- The court has strong powers to deal with instances of deliberate delay by a party and incompetence or bias on the part of an arbitrator (sec 45 and 46).
- An arbitrator is not liable for negligence (but is liable for fraud) in respect of the arbitration (sec 51).
- The arbitration system is specifically intended to encourage arbitration.

10. *IBM Australia Ltd v National Distribution Services Ltd* (1991) 22 NSWLR 466; (1991) ATPR ¶41-094.

of disputes arising under international agreements; the *International Arbitration Act 1974* (Cth) was amended to adopt the UNCITRAL Model Law (in 1989) and to adopt the ICSID Convention (in 1990).¹¹ The Commonwealth Act also recognises and incorporates the provisions of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (sec 56-59; Schedule 2).

- The *Evidence Act 1995* (Cth) also applies to arbitrations to some extent to govern procedures. Rights under evidence law and opportunities to examine witnesses must be given to parties to arbitrations.

Scott v Avery clause. Public policy as interpreted by the courts prevents parties from agreeing to oust the jurisdiction of the courts to settle disputes arising between them. In domestic arbitrations, any contractual provision purporting to oust the jurisdiction of the courts or to make arbitration a condition precedent to legal proceedings is void. A clause in a contract, as in the leading case of *Scott v Avery*,¹² could lawfully provide for arbitration as a condition precedent to legal action because it has been deemed not to deprive the parties of possible court proceedings after the completion of the arbitration.

Although they do not prevent court proceedings, *Scott v Avery* clauses provide obstacles where there are a number of defendants such as a builder, engineer and architect if the builder chooses to invoke the clause (as is the builder's right under a building contract). To overcome this restriction, sec 55 of the uniform Commercial Arbitration legislation of 1984-1990 effectively does away with the *Scott v Avery* clause altogether, provides that it does not operate or cannot operate to stop legal proceedings being maintained, and prohibits any clause purporting to make arbitration a condition precedent to legal proceedings.

Powers of the court. The Supreme Court has the power of overall supervision. Section 38 of the uniform Commercial Arbitration legislation of 1984-1986 seeks to maintain the authority of awards by effectively abolishing the right of the parties to appeal to the court to have an award set aside on the ground of "error on the face of the award" and now provides for judicial review of awards only with the consent of all the parties or with the leave of the court, and only "on the ground of error of fact or law on the face of the award".¹³ The uniform legislation further seeks to reinforce the authority of awards by prohibiting leave to appeal to the court if the parties have signed a written "exclusion agreement" excluding such appeal (sec 40) unless the dispute falls within the court's Admiralty jurisdiction, or arises out of a contract of insurance or out of a commodity contract (sec 41).

11. International Centre for Settlement of Investment Disputes.

12. (1856) 5 HL Cas 811; 10 ER 1121; ¶5-835; ¶17-800.

13. eg *Promenade Investments Pty Ltd v New South Wales* (1992) 26 NSWLR 203, noted (1992) 66 ALJ 327.

Arbitration awards based on a written submission are enforceable by leave of the court like a judgment or other court order by means of a writ of execution, a writ of attachment, an order for specific performance and, because the submission is a mutual agreement to perform the award of the arbitrators, by court action. The uniform Commercial Arbitration legislation of 1984-1990 (sec 33) and the Commercial Arbitration rules of the court set out and simplify enforcement of an arbitrator's award.

The court retains the power to set aside an award for abuse of process such as misconduct by an arbitrator or umpire or the improper procuring of an award (sec 42). Other powers of judicial review retained by the court include the power to remove an arbitrator or umpire for misconduct, the exercise of undue influence, incompetence or unsuitability (sec 44); the power to terminate the proceedings upon application by the arbitrator or umpire in the event of undue delay by a claimant (sec 46); the power to make interlocutory orders (sec 47);¹⁴ the power to extend time (sec 48) and the power to impose terms and conditions on orders including terms and conditions as to costs (sec 49).

— Case examples —

Erection and completion of the Qantas Centre in Sydney by Dillingham Constructions was not smooth. Qantas (P) brought legal proceedings against the defendant builder and others (D), claiming that because D found the building contract to be too onerous, it attempted to force P to renegotiate the contract in D's favour by wrongful means such as delay, inducing labour unrest, conspiracy with other parties to hinder performance of the work and fraudulently misrepresenting that problems in the design made work under the contract impracticable. By way of defence to P's legal proceedings, D sought a court order to remit the dispute to arbitration by an architect and a builder, or by an arbitrator mutually appointed as set out in the *Scott v Avery* clause contained therein.

In upholding D's defence, Rogers J issued an interim order to stay the legal proceedings under sec 53 of the *Commercial Arbitration Act 1984* (NSW) and/or under the *Supreme Court Rules* (NSW) — amended in 1984 to enable the court to refer any matter to arbitration either on application of a party or by its own motion. This order was designed so that the parties could clear up the questions for final determination, in particular their matching fraud claims (D's alleged fraudulent misrepresentation on building design; P's alleged fraudulent inducement to D to enter a deed of settlement of lengthy arbitration proceedings) which would normally justify trial by jury. This order carried into effect the arbitration clause contained in the parties' contract. Rogers J upheld the court's power to stay the legal proceedings under uniform sec 53 and in particular rejected the following arguments:

- (1) that because only one or two of the several defendants were party to the contract, the other defendants could litigate in court and two sets

14. eg Jacobs, MS, *The spectre of section 47 of the Model Uniform Legislation* (1995) 69 ALJ 822.

of proceedings could run side by side — case law shows that persons not party to the original contract can be joined in arbitration proceedings;

- (2) that arbitration proceedings would cause extra expense;
- (3) that the complexity of the dispute could overwhelm arbitrators.

Rogers J noted the change in attitude of the courts to arbitration with the comment: “It is now more fully appreciated than used to be the case that arbitration is an important and useful tool in dispute resolution. The former judicial hostility to arbitration needs to be discarded and a hospitable climate for arbitral resolution of disputes created.”

*Qantas Airways Ltd v Dillingham Corporation*¹⁵ —

Uluru National Park. Notice of a dispute over the construction of a road and carpark in the park was not lodged within the 28 days specified in the contract. Under the authority of sec 48, the High Court was able to extend the time for appointment of an arbitrator.

*PMT Partners Pty Ltd (in liq) v Australian National Parks & Wildlife Service*¹⁶ —

Alternative dispute resolution facilities. Alternative dispute resolution facilities have been created by government or privately to lower legal costs, to improve access to justice and to provide alternatives to the traditional court system in civil matters.

NADRAC. The Commonwealth government set up the National Alternative Dispute Resolution Advisory Council (NADRAC) in 1995 to oversee the development of alternative dispute resolution procedures, standards, accreditation and community education.

ADC. The Australasian Dispute Centre (ADC), based in Brisbane with divisions in most jurisdictions, is an umbrella organisation covering a number of groups offering specialist dispute resolution services in arbitration, mediation, conciliation and expert appraisal. The ADC provides appointment and administrative services in all areas of non-court dispute resolution.

CIAA. The Court of International Arbitration (CIAA), associated with the ADC, directs its activities to the promotion and conduct of arbitration and other ADR processes to the resolution of international commercial disputes whether or not involving Australian entities. The CIAA maintains a panel of international arbitrators practising throughout the world.

ACICA. The Australian Centre for International Commercial Arbitration (ACICA) affiliated with the Institute of Arbitrators and Mediators Australia was opened in Melbourne in 1985. Reflecting its “official” backing in the commercial arbitration world, the Melbourne ACICA is available for arbitrations held under the United Nations Committee on International Trade Law (UNCITRAL) Rules, the Rules of the London Court of International Arbitration and other rules of the parties’ choice such as those set out in the uniform Commercial Arbitration legislation (1984-1986). In other jurisdictions

15. (1985) 4 NSWLR 113 at p 122.

16. (1995) 69 ALJR 829.

the ACICA operates through facilities in Sydney, Brisbane and Darwin, and elsewhere through the Institute of Arbitrators and Mediators Australia.

ACDC. The Australian Commercial Disputes Centre (ACDC) was opened in Sydney in 1986, with representation in interstate centres including Brisbane and Perth. The ACDC is not arbitral and instead focuses on mediation and training of mediators. In addition to administering alternative dispute resolution processes, the ACDC's dispute resolution facilitator staff can go out to meet with companies and government departments to persuade both or all parties to engage in an alternative dispute resolution process. Staff can assist the parties to devise a particular process for their individual dispute, often including a combination of the use of different processes in the one dispute.

The ACICA and the ACDC are intended to provide complementary functions, with the ACICA focusing on domestic and international arbitrations and the ACDC focusing on alternative dispute resolution.

Australian arbitration is held in high regard overseas, and Australian arbitrators as independents are sometimes called upon to settle off-shore disputes, including those which have nothing to do with Australia.

¶1-444 Alternative dispute resolution conspectus. The development of alternative dispute resolution provides an extra dimension to the legal system. But every development has both benefits and costs.

The advantages of alternative dispute resolution can be listed as:

- (1) less formal, quicker and usually less expensive than court proceedings;
- (2) creation of less hostility than traditional adversary proceedings, frequently allowing the parties to carry on their business relationship both during the alternative dispute resolution process and thereafter;
- (3) avoidance of publicity of public court proceedings and a publicly reported case law decision; because of the private proceedings, confidential information can be presented in part or whole;
- (4) technical experts to assist with (mediation) or to adjudicate technical disputes (arbitration).

On the other hand, disadvantages may include:

- (1) incompetence or bias on the part of the intermediary could lead to a wrong settlement of negotiations (mediation), a wrong decision or denial of natural justice (arbitration), and, common to mediation and arbitration, the application of incorrect legal principles (this could also be said of a judge). Some suggest that because of their training and independence, lawyers are better arbitrators than technical experts;¹⁷
- (2) "playing one's hand" and prejudicing later formal legal proceedings;

17. eg Klug, M and Dutson, S, *Role of the legal profession in arbitration* (2000) ALJ 42.

- (3) expense, delays and generally unproductive proceedings satisfying neither party and propelling them back to the traditional court system.

There has been a general decrease in commercial litigation in Australia in recent times, and arbitration has also fallen off due to the reservations of some commercial entities — whether justified or not — to submit to a process in which they have doubts.

In contrast, commercial arbitration is expanding rapidly in some jurisdictions. For example, in the US the number of arbitrations is doubling every 2.5 years.

REGULATION OF BUSINESS UNDER STATE AND FEDERAL CONSTITUTIONS _____

Commonwealth and State Constitutions	¶1-450
Regulation of Australian business law	
1788-1900	¶1-455
The Commonwealth Constitution 1900	¶1-460
Constitutional restrictions on the law-making	
powers of the State Parliaments	¶1-470
Constitutional restrictions on the law-making	
powers of the Commonwealth Parliament	¶1-475
Business regulation under the Commonwealth	
Constitution	¶1-480
The <i>Australia Act 1986</i>	¶1-485

¶1-450 Commonwealth and State Constitutions. The Constitutions of each State and of the Commonwealth are contained in Acts of the English (or “Imperial”)¹⁸ Parliament which provide the blueprint for government. Legislation (enacted law) regulating Australian business passed at any of the three levels of government — federal, State or Territory, and local — must come within the legislative authority of the law-making authority. Case law (unenacted law) regulating business is handed down by judges in courts set up by constitutions.

¶1-455 Regulation of Australian business law 1788-1900. When the British authorities established a convict colony in New South Wales in 1788, the occupied land was not considered by current constitutional theory to be owned by any group or state and no recognised legal system was considered to exist. Aboriginal occupation for many thousands of years was not considered to give any land rights to those occupants at common law and accordingly the colony was first “settled” by the British. Being a “settled” colony, the then constitutional theory stated that the first settlers carried with them as their common law birthright so much of the existing common law as was applicable to their own situation and the condition of

18. Meaning, of the then British Empire.

the infant colony. This was called the received common law, and it included the rules of inheritance and the right to protection from personal injuries.¹⁹ After *Mabo's case* in 1992, the Australian common law now "recognises a form of native title which, in the cases where it has not been extinguished, reflects the entitlement of the indigenous inhabitants, in accordance with their laws or customs, to their traditional lands ...".²⁰

The early governors of New South Wales were naval and army commanders with the complete powers appropriate to a military post and they ruled in a state of martial law. Economic life of the colony was dominated by the needs of the administration, and early business dealings in the first few years were regulated by the New South Wales Corps and its monopoly of the available supplies.

The common law rights of the growing number of free settlers were enforced in primitive courts, and conflict developed as to the extent to which the common law applied to regulate life and early Australian business dealings, enforceability of contracts, land rights, etc. In response, the English Parliament enacted the *New South Wales Act* in 1823 giving New South Wales the status of a full colony.²¹ A limited legislature was established with members appointed by the King, but only the Governor could propose laws, and the legislature could only pass laws which were consistent with the laws of England as far as local circumstances would allow.

Doubts still remained about the applicability of English common law, and these were resolved with the enactment of the *Australian Courts Act 1828* (Imp)²² which proclaimed that all English laws existing up to 1828 were in force in New South Wales and Tasmania as far as they could apply to the conditions of the colonies. This would have included the *Statute of Frauds 1677* (Imp) (§5-030), contract law, partnership law and the many still-accepted principles of modern business law evolved by Lord Mansfield in the late eighteenth century (such as the principle of good faith in insurance: §17-310).

19. Blackstone, W, *Commentaries on the Laws of England*, Oxford, Clarendon Press, 1765, Volume I, pp 105-106. In contrast, if New South Wales had been considered a "conquered" or "ceded" colony, existing local law would have continued in force until altered by Parliament or the Crown.

20. *Mabo v Queensland (No 2)* (1992) 175 CLR 1 at p 15; (1992) 66 ALJR 408 at p 410, §3-425, noted, eg, (1993) 67 ALJ 442, Latimer, P, *Common law native title* (1993) 67 LIJ 844; Brennan, F, SJ, *The implications of the Mabo decision*, Reform, Issue 65, p 11 (Autumn 1993); National Native Title Tribunal, §7-730.

Preceding *Mabo*, in the preamble to the *Aboriginal and Torres Strait Islander Heritage Protection Amendment Act 1987* (Cth), passed by the Commonwealth at the request of and for Victoria, "the Government of Victoria acknowledges ... the occupation of Victoria by the Aboriginal people before the arrival of Europeans": [1987] Reform 68.

21. 4 Geo IV c 96 (Imp, 1823).

22. Long title: An Act to provide for the Administration of Justice in New South Wales and Van Diemen's Land, and for the more effectual Government thereof, and for other purposes relating thereto. 9 Geo IV, c 83 (Imp, 1828).

Henceforth English laws passed after 1828 could only apply in New South Wales and Tasmania if they were expressly so intended by “paramount force”. Rigid Imperial control remained because post-1828 English legislation, applying by paramount force, could not be amended or altered locally. All English law still applied in Western Australia (established in 1829) and South Australia (established in 1834).

As the colonies developed, responsible or representative government, with the elected leaders responsible to the electors for their decisions, was progressively granted by the various colonial Constitution Acts passed by the Imperial Parliament for New South Wales (1842, 1855); Victoria (1850); Tasmania (1856); South Australia (1856); Queensland (1867) and Western Australia (1870, 1890). These Constitution Acts generally established independence and vested the colonial legislature with the power to legislate for “peace, order and good government”.

To settle remaining doubts on the jurisdiction of the colonial legislatures, the Imperial Parliament passed in 1865 what is considered the charter of colonial freedom. The *Colonial Laws Validity Act 1865*²³ (in force in Australia until 1986: ¶1-485) established the rights of the colonies to legislate in any way, the only limit under sec 2 being that “[a]ny colonial law which is ... in any respect repugnant” to any Imperial Act extending to the colony by paramount force is “absolutely void”. Further, the power of colonial legislatures to alter their constitutions was confirmed in sec 5 so long as consistent with the prescribed “manner and form” requirements of the relevant Imperial or colonial law. In fact, this ultimate legal supremacy of the Imperial Parliament was never used to limit colonial legislation, but was used instead as a supplement and was no barrier to effective full self-government.

¶1-460 The Commonwealth Constitution 1900. Economic development in the Australian colonies through the second half of the nineteenth century, improved communications as railways linked all centres from 1883, and development of some sense of Australian nationhood led to discussions on the federation of the Australian colonies (and possibly New Zealand and Fiji) to deal with common matters such as defence, internal customs barriers and immigration. National business regulation was neither called for nor considered to be an issue (¶1-480).

Australia as a federation was established by an Act of the Imperial Parliament called the *Commonwealth of Australia Constitution Act 1900* (Imp)²⁴ to which the Australian Constitution is the Schedule. The federation involves both the political integration of the former colonies, and a limited level of economic integration. The Constitution carries out five main tasks:²⁵

23. 28 & 29 Vict, c 63 (Imp).

24. 63 & 64 Vict, c 12 (Imp).

25. Sawyer, G, *The Australian Constitution*, AGPS, 2nd ed, 1988, p 22.

- (1) It recognises the existence of the six Australian colonies as they were in 1900, and continues in force their constitutions and laws except as changed by the Commonwealth Constitution.
- (2) It creates a new set of “federal” or “Commonwealth” authorities of the central government, and outlines their functions and powers.
- (3) It regulates the relations between Commonwealth authorities and those of the States.
- (4) It establishes an Australian common market by providing for free trade between the States and a common external customs tariff.
- (5) It establishes limited “Bill of Rights” provisions such as the right to vote (sec 41), the right to trial by jury (sec 80), the right to no discrimination between States (sec 99) and the right to freedom of religion (sec 116).

Nowhere is there any concept of a “federal balance” in the Constitution. The suggestion of any equilibrium between Commonwealth and State powers is not authorised and would advance ideas of “reserved State powers” in the face of particular federal powers:

“In point of fact, references to a ‘federal balance’ are objectionable as not being sufficiently explicit in identifying how and to what extent the claimed State powers involved in the ‘balance’ are affected. Its relevance even in political terms, by reason of this lack of explicitness, is also dubious.”²⁶

¶1-470 Constitutional restrictions on the law-making powers of the State Parliaments. The existence of a Parliament does not necessarily mean unlimited powers of law-making, and various constitutional limitations restrict the powers of the State and Territory Parliaments (as well as the Commonwealth Parliament in Canberra (¶1-475)) to pass laws including laws for the regulation of business.

State Constitutions authorise State legislation only for the peace, order and good government of the State, including laws having extra-territorial operation: *Australia Act 1986* (Cth) sec 2(1).

The Colonial Laws Validity Act 1865 (Imp):

- (1) until 1986, rendered void and inoperative any State legislation repugnant to Imperial legislation intended to apply in the State — such as the *Merchant Shipping Act 1894* (Imp) and the *Australian States Constitution Act 1907* (Imp);
- (2) required that any amendment to a State Constitution must comply with the “manner and form” procedural requirements set out in the relevant law (¶1-455).

26. *The concept of the “federal balance”*
(1986) 60 ALJ 653 at p 654.

The *Australia Act 1986* (Cth), discussed at ¶1-485, provides that the *Colonial Laws Validity Act 1865* does not apply to any State law made after the commencement of the Act.

The Commonwealth Constitution:

- (1) grants concurrent and exclusive powers to the Commonwealth. Concurrent powers (like taxation, banking, insurance) are shared between Commonwealth and State; exclusive powers (like defence, customs, excise) are vested in the Commonwealth only. If there is any inconsistency between a State law and a Commonwealth law, sec 109 of the Constitution (reproduced in ¶1-475 below) provides that the Commonwealth law is to prevail. Inconsistencies may arise where it is impossible to obey both laws (a direct collision), where the Commonwealth law allows and the State law prohibits, and where the Commonwealth law intends to cover the field to the exclusion of any State law.
- (2) imposes explicit restrictions upon the States. Section 92 of the Constitution limits State taxation and regulation by providing that interstate trade is to be absolutely free; sec 114 prohibits any State from having its own army or navy, or taxing Commonwealth property, without Commonwealth consent; sec 115 prohibits a State from making its own money and sec 117 protects a resident of one State from any disability or discrimination while in another State.

¶1-475 Constitutional restrictions on the law-making powers of the Commonwealth Parliament. The Commonwealth Constitution reflects the agreement of the colonial (later State) politicians and representatives who drafted the Constitution in the 1890s and who jealously guarded their existing colonial powers.²⁷ Section 107 provides that all the rights and powers of the States which they held as colonies prior to federation in 1900 are preserved unless expressly taken away by the Commonwealth Constitution. The Commonwealth's power to pass law is limited by the doctrine of the "separation of powers" and by the legislative powers of the Parliament under the Commonwealth Constitution.

The doctrine of the "separation of powers". This doctrine, formulated by French philosopher and jurist Montesquieu in 1748, explained the protection of the liberty of the citizen under the common law because total power of government is divided among three branches of government (¶1-490):

- (1) the legislature, which *makes* the laws;
- (2) the executive, which *administers* the laws; and
- (3) the judicature, which *interprets, applies and enforces* the laws.

But, unlike the presidential situation under the US Constitution, parliamentary control over the execution of laws is constitutionally permissible and does not clash with the doctrine of separation of powers.

27. Centenary of the *Australasian Federation Conference of 1890* (1990) 64 ALJ 611.

Because all three powers are in theory not held by one person or group, autocratic and arbitrary rule is not possible because each body provides a check upon the other to ensure that power is not abused or exceeded:

(1) Legislative power (sec 1):

“CHAPTER I
THE PARLIAMENT
PART I — GENERAL

1. The legislative power of the Commonwealth shall be vested in a Federal Parliament, which shall consist of the Queen, a Senate, and a House of Representatives, and which is herein-after called ‘The Parliament’, or ‘The Parliament of the Commonwealth.’”

(2) Executive power (sec 61):

“CHAPTER II
THE EXECUTIVE GOVERNMENT

61. The executive power of the Commonwealth is vested in the Queen and is exercisable by the Governor-General as the Queen’s representative, and extends to the execution and maintenance of this Constitution, and of the laws of the Commonwealth.”

(3) Judicial power (sec 71):

“CHAPTER III
THE JUDICATURE

71. The judicial power of the Commonwealth shall be vested in a Federal Supreme Court, to be called the High Court of Australia, and in such other federal courts as the Parliament creates, and in such other courts as it invests with federal jurisdiction. The High Court shall consist of a Chief Justice, and so many other Justices, not less than two, as the Parliament prescribes.”

Judicial power of the Commonwealth. Only a court may exercise “judicial power” — “the power exercised by courts ... [which] can only be defined by reference to what courts do and the way in which they do it”.²⁸ A non-court, such as a tribunal or a commission, exercising judicial power is in breach of sec 71 of the Constitution:

- the Corporations and Securities Panel does not exercise judicial power;²⁹
- the making of “determinations” under the *Racial Discrimination Act 1975* (Cth) by the Human Rights and Equal Opportunity Commission was an invalid exercise of judicial power.³⁰

Legislative powers of the Commonwealth Parliament. In contrast to the States, the only powers possessed by the Commonwealth are those transferred

28. *Brandy v Human Rights and Equal Opportunity Commission* (1995) 183 CLR 245 at p 267.

30. *Brandy v Human Rights and Equal Opportunity Commission* (1995) 183 CLR 245.

29. *Precision Data Holdings v Wills* (1991) 173 CLR 167.

to it by agreement of the colonial (later State) politicians and representatives in the 1890s which were given effect in the Commonwealth Constitution. As a result, the Commonwealth possesses most powers *concurrently* with the States, and some (few only) *exclusively* for itself; it therefore cannot pass unlimited business law.

Constitutional interpretation further limits the powers of the Commonwealth. Because its powers are specifically listed and contained in the Constitution, by interpretation the Commonwealth is limited to those powers alone; for example, the power over corporations is limited to the three classes set out in sec 51(xx) and no other (§17-220). To work out whether a law is a law “with respect to” a head of power in sec 51, two questions must be asked:³¹

- (1) What is the character of the law? Refer to the rights, powers, liabilities, duties and privileges which it creates.
- (2) Is the law connected to a head of power in sec 51? This involves referring to practical as well as legal considerations.

If a connection exists between the law and a sec 51 head of power, the law is a law “with respect to” that head of power unless the connection is so insubstantial or distant that it cannot sensibly be described as such a law.

Commonwealth legislation must therefore fall within one of the following heads of power:

“PART V — POWERS OF THE PARLIAMENT

51. The Parliament shall, subject to this Constitution, have power* to make laws for the peace, order, and good government of the Commonwealth with respect to:—

- (i) Trade and commerce with other countries, and among the States:
- (ii) Taxation; but so as not to discriminate between States or parts of States:
- (iii) Bounties on the production or export of goods, but so that such bounties shall be uniform throughout the Commonwealth:
- (iv) Borrowing money on the public credit of the Commonwealth:
- (v) Postal, telegraphic, telephonic, and other like services:
- (vi) The naval and military defence of the Commonwealth and of the several States, and the control of the forces to execute and maintain the laws of the Commonwealth:
- (vii) Lighthouses, lightships, beacons and buoys:
- (viii) Astronomical and meteorological observations:

*“ The following Imperial Acts extended the legislative powers of the Parliament:
Whaling Industry (Regulations) Act, 1934, s 15
Geneva Convention Act, 1937, s 2
Emergency Powers (Defence) Act, 1939, s 5
Army and Air Force (Annual) Act, 1940, s 3.”

31. eg *Re Dingjan; ex parte Wagner* (1995)
183 CLR 323, per *McHugh J* at p 369.

- (ix) Quarantine:
- (x) Fisheries in Australian waters beyond territorial limits:
- (xi) Census and statistics:
- (xii) Currency, coinage, and legal tender:
- (xiii) Banking, other than State banking; also State banking extending beyond the limits of the State concerned, the incorporation of banks, and the issue of paper money:
- (xiv) Insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned:
- (xv) Weights and measures:
- (xvi) Bills of exchange and promissory notes:
- (xvii) Bankruptcy and insolvency:
- (xviii) Copyrights, patents of inventions and designs, and trade marks:
- (xix) Naturalization and aliens:
- (xx) Foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth:
- (xxi) Marriage:
- (xxii) Divorce and matrimonial causes; and in relation thereto, parental rights, and the custody and guardianship of infants:
- (xxiii) Invalid and old-age pensions:
- (xxiiiA) The provision of maternity allowances, widows' pensions, child endowment, unemployment, pharmaceutical, sickness and hospital benefits, medical and dental services (but not so as to authorize any form of civil conscription), benefits to students and family allowances:
- (xxiv) The service and execution throughout the Commonwealth of the civil and criminal process and the judgments of the courts of the States:
- (xxv) The recognition throughout the Commonwealth of the laws, the public Acts and records, and the judicial proceedings of the States:
- (xxvi) The people of any race, ~~other than the aboriginal race in any State~~, for whom it is deemed necessary to make special laws:
- (xxvii) Immigration and emigration:
- (xxviii) The influx of criminals:
- (xxix) External affairs:
- (xxx) The relations of the Commonwealth with the islands of the Pacific:
- (xxxi) The acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws:
- (xxxii) The control of railways with respect to transport for the naval and military purposes of the Commonwealth:

Inserted by
No 81, 1946,
s 2.

Altered by
No 55, 1967,
s 2.

- (xxxiii) The acquisition, with the consent of a State, of any railways of the State on terms arranged between the Commonwealth and the State:
- (xxxiv) Railway construction and extension in any State with the consent of that State:
- (xxxv) Conciliation and arbitration for the prevention and settlement of industrial disputes extending beyond the limits of any one State:
- (xxxvi) Matters in respect of which this Constitution makes provision until the Parliament otherwise provides:
- (xxxvii) Matters referred to the Parliament of the Commonwealth by the Parliament or Parliaments of any State or States,^[32] but so that the law shall extend only to States by whose Parliaments the matter is referred, or which afterwards adopt the law:
- (xxxviii) The exercise within the Commonwealth, at the request or with the concurrence of the Parliaments of all the States directly concerned, of any power which can at the establishment of this Constitution be exercised only by the Parliament of the United Kingdom or by the Federal Council of Australasia:
- (xxxix) Matters incidental to the execution of any power vested by this Constitution in the Parliament or in either House thereof, or in the Government of the Commonwealth, or in the Federal Judicature, or in any department or officer of the Commonwealth.”

The more important of these 40 powers can be grouped as follows:³³

- defence and foreign affairs — (vi), (ix), (xxviii), (xxix), (xxx), (xxxii);
- fiscal powers — (ii), (iv);
- population policy — (xix), (xxvii);
- provision of public facilities and social services — (v), (vii), (viii), (xi), (xxiii), (xxiiiA);
- family law — (xxi), (xxii);
- commercial and industrial regulation — (i), (iii), (x), (xii), (xiii), (xiv), (xv), (xvi), (xvii), (xviii), (xx), (xxxv);
- relations with States — (xxiv), (xxv), (xxxiii), (xxxiv).

All of these powers are in theory held concurrently with the States although in political reality and by law (sec 109) it may be difficult for a State to pass or to enforce a law in an area already legislated for by the Commonwealth. However, certain powers are stated to be exclusive to the

32. Matters referred are listed in the Constitution. 33. Sawyer, G, *op cit*, p 24.

Commonwealth, which means that only the Commonwealth Parliament can make laws on that topic. Section 52 introduces the exclusive powers of the Commonwealth.

Exclusive powers of the Parliament

“52. The Parliament shall, subject to this Constitution, have exclusive power to make laws for the peace, order, and good government of the Commonwealth with respect to—

- (i) The seat of government of the Commonwealth, and all places acquired by the Commonwealth for public purposes;
- (ii) Matters relating to any department of the public service the control of which is by this Constitution transferred to the Executive Government of the Commonwealth;
- (iii) Other matters declared by this Constitution to be within the exclusive power of the Parliament.”

Similar powers exclusive to the Commonwealth exist with respect to customs, excise and bounties (sec 90); naval and military forces (sec 114); currency (sec 115) and the government of federal territories (sec 122):

[Exclusive power over customs, excise, and bounties.]

“90. On the imposition of uniform duties of customs the power of the Parliament to impose duties of customs and of excise, and to grant bounties on the production or export of goods, shall become exclusive.

On the imposition of uniform duties of customs all laws of the several States imposing duties of customs or of excise, or offering bounties on the production or export of goods, shall cease to have effect, but any grant of or agreement for any such bounty lawfully made by or under the authority of the Government of any State shall be taken to be good if made before the thirtieth day of June, one thousand eight hundred and ninety-eight, and not otherwise.”

[Trade within the Commonwealth to be free.]

“92. On the imposition of uniform duties of customs, trade, commerce, and intercourse among the States, whether by means of internal carriage or ocean navigation, shall be absolutely free ...”

[Taking over public debts of States.] Altered by No 3, 1910, s 2.

“105. The Parliament may take over from the States their public debts ~~as existing at the establishment of the Commonwealth~~, or a proportion thereof according to the respective numbers of their people as shown by the latest statistics of the Commonwealth, and may convert, renew, or consolidate such debts, or any part thereof; and the States shall indemnify the Commonwealth in respect of the debts taken over, and thereafter the interest payable in respect of the debts shall be deducted and retained from the portions of the surplus revenue of the Commonwealth payable to the several States, or if such surplus is insufficient, or if there is no surplus, then the deficiency or the whole amount shall be paid by the several States.”

[States may not raise forces. Taxation of property of Commonwealth or State.]

“114. A State shall not, without the consent of the Parliament of the Commonwealth, raise or maintain any naval or military force, or impose any tax on property of any kind belonging to the Commonwealth, nor shall the Commonwealth impose any tax on property of any kind belonging to a State.”

[States not to coin money.]

“115. A State shall not coin money, nor make anything but gold and silver coin a legal tender in payment of debts.”

[Government of territories.]

“122. The Parliament may make laws for the government of any territory surrendered [sic] by any State to and accepted by the Commonwealth, or of any territory placed by the Queen under the authority of and accepted by the Commonwealth, or otherwise acquired by the Commonwealth, and may allow the representation of such territory in either House of the Parliament to the extent and on the terms which it thinks fit.”

The Commonwealth Constitution and laws legally made under it override State Constitutions and laws made under them in the case of any inconsistency between them. A State law may permit while a federal law prohibits certain conduct; in such case, sec 109 provides that the State law, to the extent of inconsistency, shall be invalid.

Inconsistency of laws

“CHAPTER V
THE STATES”

[Saving of Constitutions.]

“106. The Constitution of each State of the Commonwealth shall, subject to this Constitution, continue as at the establishment of the Commonwealth, or as at the admission or establishment of the State, as the case may be, until altered in accordance with the Constitution of the State.”

[Saving of Power of State Parliaments.]

“107. Every power of the Parliament of a Colony which has become or becomes a State, shall, unless it is by this Constitution exclusively vested in the Parliament of the Commonwealth or withdrawn from the Parliament of the State, continue as at the establishment of the Commonwealth, or as at the admission or establishment of the State, as the case may be.”

[Saving of State laws.]

“108. Every law in force in a Colony which has become or becomes a State, and relating to any matter within the powers of the Parliament of the Commonwealth, shall, subject to this Constitution, continue in force in the State; and, until provision is made in that behalf by the Parliament of the Commonwealth, the Parliament of the State shall have such powers of alteration and of repeal in respect of any such law as the Parliament of the Colony had until the Colony became a State.”

[Inconsistency of laws.]

“109. When a law of a State is inconsistent with a law of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid.”

The Statute of Westminster 1931 (Imp). This Imperial statute, passed in 1931, and adopted by Australia in 1942 retrospectively from 1939,³⁴ removed the

34. *Statute of Westminster Adoption Act 1942* (Cth).

then-existing Imperial limitations on Commonwealth authority to legislate. Before the adoption of this statute, the *Colonial Laws Validity Act 1865* (Imp) (¶1-455) (repealed as applies to Australia: ¶1-485) applied to the Commonwealth and its laws were therefore subject to the indignity of being void if repugnant to English law passed to apply to the Commonwealth. To meet modern realities, the *Statute of Westminster* provides that:

- (a) the *Colonial Laws Validity Act 1865* (Imp) does not apply to Commonwealth law (sec 2);
- (b) the Commonwealth Parliament has full power to pass laws having extra-territorial effect (sec 3).

As discussed at ¶1-485, the *Australia Act 1986* (Cth) sec 12 repealed sec 4, 9(2) and (3) and 10(2) of the *Statute of Westminster* in so far as they formed part of the law of the Commonwealth, of a State or of a Territory.

Further, the High Court has rejected the authority of nineteenth century British legislation to limit the power of the Commonwealth Parliament to pass laws. In upholding the validity of the *Navigation Amendment Act 1979* (Cth), which repealed the *Merchant Shipping Act 1894* (Imp), the court confirmed that federation in 1900 ended British control over the former Australian colonies, and any supposed continuing British legislative authority would be inconsistent with Australia's sovereignty.³⁵ By an exercise of its external affairs power (Constitution sec 51(xxix)), the Commonwealth can repeal a British statute applying to either the Commonwealth or a State.

¶1-480 Business regulation under the Commonwealth Constitution. The Commonwealth has limited authority over national business and economic regulation. The colonial (later State) politicians and representatives who drafted the Constitution in the 1890s jealously guarded their existing semi-independence and only agreed to transfer limited national matters to the proposed Commonwealth, such as the power over defence, postage and immigration (¶1-475). At that time Australia was made up of six colonies, each with well developed relationships with the UK, and there was little national business or call for national business regulation by the proposed Commonwealth government. Limited business regulation powers which were granted to the Commonwealth included those in sec 51(iv), 51(xii), 105 and 115.

With some ingenuity, assistance from High Court centralist constitutional decisions and/or Commonwealth/State co-operative agreements, particular areas of Commonwealth business regulation now include:

Commonwealth crimes legislation. Although there is no direct authority in the Constitution for the making of federal law on crime, numerous federal criminal statutes exist based on varying sections. There is the *Crimes*

35. *Kirmani v Captain Cook Cruises Pty Ltd* (No 1) (1985) 159 CLR 351; (No 2) (1985) 159 CLR 461.

(*Aircraft Act 1963* (based on sec 51(i)); the *Crimes (Taxation Offences) Act 1980* (sec 51(ii)); the *Crimes Act 1914* (Cth) (based on sec 51(vi), the power of self-protection, as well as sec 51(xii), sec 51(xxix) and sec 51(xxxix)). These sections also authorise the *Financial Transaction Reports Act 1988* (Cth) and the *Proceeds of Crime Act 1987* (Cth) (¶16-080).

Commonwealth trade practices legislation. The Commonwealth apparently has no power to regulate unfair and anti-competitive trade practices (¶7-220) yet the *Trade Practices Act 1974* (Cth) has been passed in reliance upon sec 51(i) (trade and commerce), sec 51(v) (postal, etc), sec 51(xx) (corporations), sec 51(xxix) (external affairs) (in the case of *Trade Practices Act 1974* (Cth) sec 55: ¶7-410), sec 52 (Commonwealth instrumentalities) and sec 122 (Commonwealth territories). All of these sections of the Constitution are reproduced at ¶1-475.

Commonwealth insurance legislation. The 1985 reforms of insurance law (see Chapter 17) would be based on at least sec 51(xiv) (perhaps augmented by the sections used for the *Trade Practices Act 1974* (Cth) (¶7-220)).

Commonwealth companies and securities legislation. Although doubts have been expressed at various times as to the power of the Commonwealth Parliament to pass federal companies and securities law under sec 51(xx) (again perhaps augmented by the sections used for the *Trade Practices Act*), the *Corporations Act 1989* (Cth) and the Corporations Law are based upon both Commonwealth and State laws to authorise federal companies and securities industry laws, and the creation of the Australian Securities and Investments Commission as a regulator accountable only to the Commonwealth Parliament (¶9-370—¶9-380).

Only the most determined “States’ Righters” would reject the view that in modern Australia the Commonwealth Parliament should have power to prevent lack of uniformity in business regulation across Australia, and sufficient macro-economic powers to manage the national economy. In its 1988 Final Report, the Constitutional Commission recommended amendment to the Constitution to give the Commonwealth Parliament a power to make laws with respect to:

- “Trade and commerce” (ie with no interstate or other limitations);
- “Incorporation, organisation and administration of corporations” (ie all corporations); and
- “Financial, investment and other like markets and services”.³⁶

36. *Final Report of the Constitutional Commission*, AGPS, Canberra, 1988, Ch 11, The National Economy. See

further *The Constitution and control of the economy* (1987) 61 ALJ 1; Mason, Chief Justice, *The Australian Constitution 1901-1988* (1988) 62 ALJ 752.

¶1-485 **The Australia Act 1986.** As discussed above, various statutes of the English Parliament formed part of the Constitution of the Australian Commonwealth (the *Statute of Westminster 1931* (Imp): ¶1-475) and of the Australian States (such as the *Colonial Laws Validity Act 1865* (Imp): ¶1-455). Amendment or repeal of this imperial legislation could not be achieved unilaterally in or from Australia, and required the process of request by the Commonwealth and all States of Australia, followed by the consent of the UK Parliament,³⁷ a process commenced at Commonwealth/State conferences in Canberra in 1982 and 1984 and completed on 2 March 1986 with the proclamation in Canberra by Her Majesty the Queen of Australia of the *Australia Act 1986* (Cth) and the *Australia (Request and Consent) Act 1985* (Cth).³⁸ This legislation completed the process of constitutional development commenced at the beginning of the century, eliminated anachronistic laws and procedures, substituted new arrangements which reflect Australia's status as an independent and sovereign nation, and ensured the capacity of the States to exercise fully the powers appropriate to their position in the Australian federation.

The legal foundation for this abolition of residual constitutional links between Australia and the United Kingdom was sec 51(xxxviii) of the Commonwealth Constitution (¶1-475) and the necessary condition precedent was the enacting by all six Australian States of legislation to achieve this purpose. Each State enacted uniform legislation called the *Australia Acts (Request) Act 1985* which requested the enactment of the *Australia Act 1986* (Cth) by the Commonwealth Parliament (sec 3), which requested and consented to the passage of the *Australia Act* by the UK Parliament (sec 4) and which requested and consented to the *Australia (Request and Consent) Act 1985* (Cth) passed by the Commonwealth Parliament (sec 5).

The *Australia Act 1986* (Cth) terminated any powers that might still remain in the United Kingdom Parliament to make laws having effect as part of the Australian law (sec 1). It declared that the legislative powers of State Parliaments include full power to make laws having extra-territorial effect (sec 2(1)) and that their legislative powers are to include all legislative powers previously exercised by the British Parliament "for the peace, order and good government of that State" except in respect of the conduct of foreign affairs (sec 2(2)). Section 3(1) provides that the *Colonial Laws Validity Act 1865* (Imp) (¶1-455) ceases to apply to State laws made after 1986, and, by sec 3(2), that no State law "shall be void or inoperative on the ground that it is repugnant to the law of England", and that a State Parliament has the power to repeal or amend any previous Imperial legislation in so far as it is a part of the law of the State. State legislative powers set out in sec 2 and 3 are subject to sec 5 (which reminds the States that they are subject to the

37. The *Australia Act 1986* (UK) duplicates the Australian Act.

38. Outlined in *Abolition of residual constitutional links between Australia and*

the United Kingdom (1986) 60 ALJ 253; Gaudron, M, *The realisation of an Australian legal system* (1987) 61 LIJ 686.

Commonwealth Constitution, and in particular sec 109, which renders invalid State laws inconsistent with the laws of the Commonwealth) and sec 6 (which reminds the States that amendments to State Constitutions must be in accordance with the entrenched “manner and form” requirements set out in their State Constitutions). The residual executive powers of the UK government with respect to the States are terminated (sec 10). As discussed at ¶1-150, sec 11 terminated appeals to the Privy Council from Australian courts.

INTERPRETATION OF STATUTES

Constitutional theory of the separation of powers	¶1-490
The literal approach	¶1-500
The golden rule	¶1-510
The mischief rule	¶1-520
Purposive approach to interpretation	¶1-530
General approaches to statutory interpretation	¶1-540
Use of extrinsic material for statutory interpretation	¶1-550


¶1-490 Constitutional theory of the separation of powers.

The Australian and other common law legal systems are founded on the theory and the ideal of the separation of powers between the three branches of government:

- the legislature (the Parliament),
- the executive (the administration or the public service), and
- the judiciary (the courts): ¶1-475.

The Parliament, elected by the people, is the supreme law-maker (it passes enacted law: ¶1-180; ¶1-200). The laws made by Parliament are given effect by the courts, whose function is the application and the interpretation of those laws.

In many areas of law, such as tort, contract and equity, where Parliament has passed no laws, the courts through their judgments are able to make judge-made law (unenacted or common law: ¶1-180; ¶1-350).

 Statutory interpretation is a matter of deciding what is the law. Any question of law is to be decided by the judge (not the jury — the jury decides questions of fact): ¶2-120. The statutes passed by Parliament can give rise to difficulties of interpretation — what exactly do particular words or expressions mean?

A number of preliminary definitions are settled by the explanations contained in the (Acts) Interpretation Act of each jurisdiction (Cth 1901; Vic 1984; NSW 1987; Qld 1954; SA 1915; WA 1984; Tas 1931; NT 1978; ACT 1967; ¶1-200) where “official” meanings are given to words like “day”, “month”, “person”, “service by post”, “court of summary jurisdiction”, “minister”, etc, and where the interchangeability of singular and plural words,

and gender inclusiveness of words “importing a gender”³⁹ are stated. Statutory interpretation beyond this becomes a matter of seeking to apply the words used by the legislature. Various approaches and presumptions have been developed by the courts to assist in the task of discovering the meaning of the statute or sections of it.

The difficulties facing the courts in statutory interpretation were stated as follows:

“The Court has before it a clear choice. It may give the provision a construction which advances the manifest purpose of the Act, cures the mischief to which, relevantly, it is addressed, and reconciles it with provisions in adjacent subsections which otherwise produce a result described by *Meagher JA* (rightly in my view) as ‘exceedingly odd’. Alternatively, the Court may ignore the realities of the parties’ relationships, accept that the Act misses the target to which it was so obviously directed and condone a result, at once capricious and irrational, which could only be justified by the possibility that Parliament was seeking to achieve a purpose which was absurd, even laughable.

Consistent with the approach to the construction of legislation when faced with such a choice, sanctioned both by the High Court of Australia and by this Court, I consider it to be my duty to adopt the construction which is consistent with the language Parliament has used, achieves the manifest purpose of the legislation, and avoids the capricious and irrational result which otherwise follows.^[40] ... When statutory words are clear, even if the purpose informing them is not immediately apparent, the courts are not at liberty to mangle them to the point where they no longer mean what they say.”⁴¹

In theory, the aim of the courts is to give effect to the intention of Parliament, but in practice the courts may have difficulty determining what the intention of Parliament was.

In giving effect to these propositions, the courts apply one or some of the following approaches to statutory interpretation:

- the literal approach (¶1-500);
- the golden rule (¶1-510);
- the mischief rule (¶1-520);
- the purposive approach (¶1-530);
- the other rules of statutory interpretation (¶1-540).

¶1-500 The literal approach. The literal approach is an approach to statutory interpretation which means that the court is to give a strict

39. *Acts Interpretation Act 1901* (Cth) sec 23.

40. *Turner v Morlend Finance Corp (Vic) Pty Ltd* (1990) ASC ¶56-006, per Kirby J at p 59,115. McHugh, Justice MH, *The*

growth of legislation and litigation (1995) 69 ALJ 37.

41. *Ibid*, per *Meagher JA* at p 59,128.

interpretation to the intention of Parliament as set out in the words actually used in the statute. The literal approach gives effect to the separation of powers principle (§1-490), and requires the judge to give effect to the words of the Parliament. Indeed, for a judge to depart from the ordinary meaning of an unambiguous provision could lead to the danger of “judicial criticism of the propriety of the acts of the legislature”⁴² which “may lead judges to put their own ideas of justice or social policy in place of the words of the statute”.⁴³

However, a strict interpretation of a statute may sometimes lead to a result which surely could not have been intended by the Parliament. This “exploitation” or “loopholing” of the words used in a statute was the basis of certain tax planning schemes upheld by the High Court in the 1970s on the grounds of “legal formalism” or “the triumph of form over substance”.⁴⁴ This approach has now been rejected by the High Court in favour of a realistic and purposive interpretation (§1-530).

§1-510 The golden rule. The golden rule qualifies the literal approach by allowing the courts to disregard the literal or actual meaning of the words used in the statute if they would produce an absurd result or a result inconsistent with the rest of the statute.

Under the golden rule, the court is to read the whole statute together and interpret it together so as to give the words their ordinary significance, unless they produce an inconsistency or an absurdity.

§1-520 The mischief rule. The mischief rule entitles a judge to identify the problem (mischief) which existed before the legislation was passed and to interpret the legislation in such a way as to suppress the mischief or advance the remedy in the legislation.

It involves an analysis of the law before the statute was passed; the problem (mischief) not covered before the statute was passed, and the objects of the legislation and the policy behind it.⁴⁵

Because the mischief rule seeks to advance the remedy of the legislation, its operation is wider than the purposive approach (§1-530), which focuses on the aim (purpose) of the legislation.

However, the courts are limited in determining what was the “mischief” because, although they have ready access to extrinsic materials such as

42. *Vacher & Sons Ltd v London Society of Compositors* [1913] AC 107 at p 130, cited by Gibbs CJ in *Cooper Brookes (Wollongong) Pty Ltd v FC of T* (1981) 147 CLR 297 at p 305.

43. *Cooper Brookes case*, loc cit, per Gibbs CJ.

44. *Coles Myer Finance Ltd v FC of T* (1992-93) 176 CLR 640, per McHugh J at p 676.

45. eg *Heydon's case* (1584) 3 Co Rep 7a; 76 ER 637.

Hansard debates, government reports, etc, these materials are not the law (§1-550).

§1-530 Purposive approach to interpretation. The purposive approach requires the interpretation of the words in the legislation to help those words achieve their purpose. The purposive approach grew out of the mischief approach, but it focuses on the purpose rather than the problem (which is the target of the mischief approach: §1-520).

At common law, there are limitations on the operation of the purposive approach:⁴⁶

“First, it [must be] possible to determine ... what the mischief was that it was the purpose of the Act to remedy; secondly, it [must be] apparent that the draftsman and Parliament had by inadvertence overlooked [it] ...; and thirdly, it [must be] possible to state with certainty what were the additional words that would have been inserted”.

Even if a court or tribunal adopts a purposive, liberal or beneficial approach to the interpretation of remedial legislation, it “is not at liberty to give it a construction that is unreasonable or unnatural”.⁴⁷

In the 1980s, many Parliaments took steps to instruct the courts to interpret legislation according to a “purposive” reading, ie a reading which reflects the apparent legislative intention. For example, the *Acts Interpretation Act 1901* (Cth) was amended in 1981 by the addition of sec 15AA(1) (see §1-320):⁴⁸

“In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.”

Purposive legislation has been criticised for at least three reasons:

- (1) Any attempt by the legislature to interfere with the judiciary blurs the separation of powers contained in the federal Constitution (§1-475) and is at least theoretically invalid.⁴⁹
- (2) Such an amendment will be ineffective unless the courts choose to make it effective. Ordinary principles of statutory interpretation will still be applicable to the meaning of sec 15AA(1) and equivalents and to statutes in general.

46. *Jones v Wrotham Park Settled Estates* [1980] AC 74 at pp 105-106.

47. *IW v City of Perth* (1997) 71 ALJR 943, per Brennan CJ and McHugh J at p 947.

48. To similar effect are the *Interpretation Act 1987* (NSW) sec 33; *Interpretation of Legislation Act 1984* (Vic) sec 35(a); *Acts Interpretation Act 1954* (Qld) sec 14A;

Acts Interpretation Act 1915 (SA) sec 22; *Interpretation Act 1984* (WA) sec 18; *Acts Interpretation Act 1931* (Tas) sec 8A (added 1992); *Interpretation Act 1967* (ACT) sec 11A; *Corporations Law* sec 109H.

49. eg Spry, ICF, *The Cooper Brookes case and statutory construction* (1981) 10 ATR 208.

- (3) The apparent plain meaning of a law will still predominate over any general statement of aims. No amount of explanation can alter the law as it stands.

These criticisms notwithstanding, judges accept that if inappropriate words are used by Parliament, perhaps unintentionally, it is legitimate for a judge to put a strained interpretation on the legislative words if the literal approach would render the words pointless or substantially ineffective.⁵⁰ Part of the judicial function is to fill gaps disclosed in legislation — and judgments⁵¹ — and to avoid a literal meaning if the literal meaning would lead to an incongruous result or defeat the objects of the legislation.⁵²

¶1-540 General approaches to statutory interpretation.

In addition to the general principles discussed above, the courts resort to further principles of interpretation. As with the major principles of statutory interpretation, these further principles are also applicable to the interpretation of any legal document (eg ¶17-620). They can be summarised as follows:⁵³

- (1) The Act is to be read as a whole or in context, and in the order in which it appears.
- (2) The meaning of the same word is assumed to be consistent.
- (3) General words are to be given their primary and natural significance: “Because of the nuances of language, it is generally safer ... to use *The Macquarie Dictionary* in preference to overseas dictionaries in providing meaning to words used in the Australian context.”⁵⁴
- (4) Technical words are to be given their technical meaning.
- (5) “[W]here a statute uses a word which has acquired a clear meaning as a legal term then prima facie it will be taken that Parliament has intended to use it with the meaning which it has so acquired, unless the context clearly discloses a contrary intention.”⁵⁵ For example, the *Wik* case held that the word “lease” used in a pastoral lease is to be defined by the rights actually conferred rather than importing all of the features of a common law lease.⁵⁶

50. *The Insurers' Guarantee Fund v GIO General Ltd* (1994) 8 ANZ Insurance Cases ¶61-213 at p 75,349 per Kirby P (NSW Court of Appeal).

51. Young, J, *How to read a judgment* (1995) 69 ALJ 960.

52. *Parramore v Duggan* (1995) 183 CLR 633, per Toohey J at p 644, citing the *Cooper Brookes* case.

53. eg Pearce, DC and Geddes, RS, *Statutory Interpretation in Australia*, Butterworths, 4th ed, 1996, Ch 2-4. See also extrinsic

material for interpretation of contracts: ¶5-030.

54. *Provincial Insurance Australia Pty Ltd v Consolidated Wood Products Pty Ltd* (1991) 25 NSWLR 541, per Kirby P at p 553.

55. *Electrolux Pty Ltd v Ormerod* (1993) ASC ¶56-235 at p 58,424 (Supreme Court of Tasmania — Appeal Court).

56. *Wik Peoples v Queensland* (1996) 187 CLR 1, per Kirby J at p 245; ¶3-425.

- (6) *Noscitur a sociis*: the meaning of a word or phrase is to be derived from its context.
- (7) *Ejusdem generis*: when general matters are referred to in conjunction with a number of specific matters of a particular kind, the general matters are limited to things of the like kind to the specific matters.
- (8) *Expressio unius est exclusio alterius*: an express reference to one matter indicates that other matters are excluded.
- (9) *Generalia specialibus non derogant*: where there is a conflict between general and specific provisions, the specific provisions prevail.
- (10) A statute should not be given retrospective operation where to do so would affect an existing right or obligation unless the statute expressly or by necessary implication requires such construction.⁵⁷
- (11) The extent to which a later Act may be able to be used to interpret the superseded Act is “debatable ... care must be taken to determine whether the amending legislation merely makes clear what was implicit in the previous law or resolves doubts about its construction”.⁵⁸
- (12) Penal provisions are to be interpreted in favour of the accused and against the prosecution.
- (13) Statutes are to be construed in accordance with common law and equitable principles.⁵⁹ When interpreting a statute, the courts assume that Parliament did not intend to abolish or to affect fundamental rights and liberties based on:
 - (a) the common law, and
 - (b) human rights treaties and conventions to which Australia is a party,
 unless expressly stated.⁶⁰
- (14) “Means” *v* “includes”. Definitions of words and expressions in legislation usually commence with either “means” or “includes”. For example:
 - the *Trade Practices Act 1974* (Cth) states that “‘supply’ ... includes ... exchange, lease, hire or hire-purchase”. The word “includes” enlarges the ordinary meaning of the defined word by giving examples and otherwise leaving the definition of “supply” open. For example “supply” in this legislation includes what might not normally be thought of as supply. In the words of *Lindgren J*, “Inclusory definitions are commonly used in order to enlarge or to clarify; to catch that which would not otherwise fall within the

57. eg *Rodway v The Queen* (1990) 169 CLR 515; (1990) 64 ALJR 305.

58. *Sun World Inc v Registrar, Plant Variety Rights* (1997) 148 ALR 447, per *French J* at p 459, noted *Plant variety rights — what is a “sale”?* (1998) 72 ALJ 115.

59. eg *Interpretation of statutes in consonance with equitable principles* (1991) 65 ALJ 375.

60. eg *Statutory interpretation and freedoms* (1999) 73 ALJ 393.

defined term, or to remove doubt as to whether something is or is not within the defined term”.⁶¹

- the *Trade Practices Act 1974* (Cth) states that “‘Commission’ ... means the Australian Competition and Consumer Commission”. This means that the defined words have exact meanings, so that for example Commission in this legislation means the ACCC and no other Commission. The effect of “means” is therefore to give an exhaustive or a limited definition.

- (15) “*And*” *v* “*or*”. “*And*” means that words or phrases are joined together and must be read together or conjunctively, whereas “*or*” means that words or phrases must be read as alternatives, separately or disjunctively.

¶1-550 Use of extrinsic material for statutory interpretation. Only in the event of ambiguity or doubt does legislation in some jurisdictions provide for the use of extrinsic material to assist interpretation. The principle that extrinsic material may be used does not operate to alter the correct technical construction of legislation or to rewrite the intention of the legislature as expressed in the legislation. “If the legislature uses language which covers only one state of affairs, a court cannot legitimately construe the words of the section in a tortured and unrealistic manner to cover another set of circumstances.”⁶² In the words of sec 15AB (added in 1984) of the *Acts Interpretation Act 1901* (Cth), which sets out the threshold and other constraints on the use of extrinsic materials:⁶³

“... if any material not forming part of the Act is capable of assisting in the ascertainment of the meaning of the provision, consideration may be given to that material—

- (a) to confirm that the meaning of the provision is the ordinary meaning conveyed by the text of the provision ... or
- (b) to determine the meaning of the provision when—
 - (i) the provision is ambiguous or obscure; or
 - (ii) the ordinary meaning conveyed ... leads to a result that is manifestly absurd or is unreasonable.”

The legislation lists material such as the following which may be considered in accordance with this provision to assist the interpretation of legislation:

- headings, marginal notes, end notes and punctuation as printed by the government printer (¶1-260; ¶1-280);

61. *Plimer v Roberts* (1998) ATPR ¶41-602 at p 40,540.

62. *Newcastle City Council v GIO General Ltd* (1997) 72 ALJR 97 at p 112.

63. To similar effect are the *Interpretation Act 1987* (NSW) sec 34(2); *Interpretation*

of Legislation Act 1984 (Vic) sec 35; *Interpretation Act 1984* (WA) sec 19(1); *Acts Interpretation Act 1931* (Tas) sec 8B (added 1992); *Interpretation Act 1967* (ACT) sec 11B; *Acts Interpretation Act 1954* (Qld) sec 14B; *Corporations Law* sec 109J.

- reports of Royal Commissions, Law Reform Commissions, committees of inquiry, etc (§1-420);
- reports of parliamentary proceedings;
- explanatory memoranda or other documents presented to Parliament.

Early criticisms of this law — for example, that reliance on extrinsic materials would lengthen proceedings and add to costs — have proved without foundation, and case law now confirms:

1. The plain meaning rule (that the ordinary meaning of a statute must be followed) remains unaffected:⁶⁴

“[One cannot] be confident of discerning ‘the intention of Parliament’ in these circumstances ... any inferences to be drawn from the parliamentary debates must in all the circumstances be unreliable. We prefer to rest our decision on the inferences to be drawn from the Act itself. We therefore leave for another day any comments as to the relevance of ‘the intention of Parliament’ to a charge of abuse of process, where that intention is not discernible in the legislation itself.”

2. Reference to extrinsic material is only an aid, and is not determinative of the statute. For example, “the explanatory memorandum cannot override the clear purpose of the Act as deduced from its own language.”⁶⁵
3. A purposive approach for tax legislation — the earlier presumption of a literal construction and an interpretation in favour of the taxpayer is now being balanced with parliamentary intent of protection of the revenue as evidenced in extrinsic materials.

64. *Mills v Meeking* (1989-1990) 169 CLR 214 at p 226; (1990) 64 ALJR 190 at p 195.

65. *Walker v In Line Couriers Pty Ltd* (1999) 73 ALJR 1084 at p 1085.

Chapter 2

Crime in the Business World

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THE CRIMINAL PROCESS

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¶2-010 What is crime? “A crime (or offence) is a legal wrong that can be followed by criminal proceedings which may result in punishment.”¹ In the broadest sense, criminal law includes all statute and case law which declares that particular conduct constitutes an offence and which prescribes a penalty for such conduct. Because these definitions of crime state that a crime is an act followed by criminal proceedings, or an act whose outcome is criminal if it has certain features which mark it as criminal, such definitions are a reminder that conduct which is criminal is defined by the Parliament and by the courts. Often criminal conduct offends the moral code (¶1-020—¶1-025):

1. Glanville Williams, *Textbook of Criminal Law*, London, Stevens & Sons, 2nd ed, 1983, p 27; Glanville Williams, *The*

Definition of Crime (1955) 8 Current Legal Problems 107.

“Criminal law connotes only the quality of such acts or omissions as are prohibited under appropriate penal provisions by authority of the State. The criminal quality of the act cannot be discerned by intuition; nor can it be discovered by reference to any standard but one: Is the act prohibited with penal consequences? Morality and criminality are far from co-extensive; nor is the sphere of criminality necessarily part of a more extensive field covered by morality — unless the moral code necessarily disapproves all acts prohibited by the State, in which case the argument moves in a circle. ... the domain of ‘criminal jurisprudence’ can only be ascertained by examining what acts at any particular period are declared by the State to be crimes, and the only common nature they will be found to possess is that they are prohibited by the State and that those who commit them are punished ...”²

Certain features of crime can be identified:

- *publicness*. The act in question is regarded as more than an offence against an individual and makes up an offence against the public in general.³
- *moral wrong*. The act in question offends society’s moral code (eg murder, theft, sexual assault), although not all conduct considered immoral (eg cheating, laziness, selfishness) is criminal, and not all criminal conduct is considered immoral (eg disobeying some rules of the road).
- *punishment*. Punishment involves imposing some form of penalty for an offence whether by way of imprisonment or some other bodily suffering or by the imposition of a fine or the loss of certain rights. Punishment is not normally designed to provide compensation for the injured person.

Basis of criminal liability. At common law, the prosecution must prove that the accused had the mental element to commit the crime (the intention, *mens rea* or guilty mind) — such as the intention to steal. In addition, the prosecution must prove that the accused carried out the criminal action or the physical conduct (the *actus reus*) — such as the theft. Some crimes may be committed by a person acting without intention, recklessness or negligence such as sexual offences where ignorance of age is no defence, illegal sales of liquor and impure or adulterated food or drugs, and breach of traffic regulations. These statutory offences are called crimes of *strict liability*, and they make up an exception to the principle that a person should not be convicted of an offence where the person’s conduct did not involve an element of moral culpability.

2. Lord Atkin in *Proprietary Articles Trade Association v Attorney-General for Canada* [1931] AC 310 at p 324.

3. Such as the offences against the public contained in, eg, *Summary Offences Act 1988* (NSW); *Summary Offences Act 1966*

(Vic); *Vagrancy Act 1966* (Vic). These Acts make illegal such activities as prostitution, assault, street offences such as loitering, being found unlawfully on premises, being in possession of house-breaking equipment or stolen goods.

Business conduct is increasingly attracting criminal penalties in such areas as occupational health and safety laws and environmental legislation. Criminal law penalises theft and related offences whether committed in person or by means of computer. Criminal penalties may be imposed on a professional person, in addition to, or even in the absence of, civil liability to the client (see ¶4-230ff). Fines for companies, and fines and possibly prison sentences for individuals such as directors and executives, may be imposed for breaches of the *Trade Practices Act 1974* (Cth) (penalties of up to \$10 million: ¶8-770 — ¶8-790) and the Corporations Law (with a million dollar fine for insider trading by a company (sec 1311-1312)).

¶2-020 Objects of the criminal law. Criminal law is generally accepted as having four main aims:

- (1) punishment or retribution — vengeance or requital (“an eye for an eye”);
- (2) deterrence — discouragement by fear of punishment;
- (3) incapacitation — to put out of action;
- (4) reformation and rehabilitation.

In particular, the effectiveness of the criminal law will arguably depend less upon any punishment prescribed than upon the certainty that the conduct in question will be followed by detection and conviction.

¶2-030 Criminal law legislation. The criminal law of the Commonwealth, the States and the Territories has its origins in the common law:

The common law jurisdictions

The criminal law of New South Wales, Victoria and South Australia retains the common law of crime. Each State has passed legislation which is based on the continuation of the common law — the *Crimes Act 1900* (NSW), *Crimes Act 1958* (Vic), and the *Criminal Law Consolidation Act 1935* (SA) — which sets out offences and punishments. The criminal law of the Australian Capital Territory is substantially the same as that of New South Wales.⁴

The Code jurisdictions

Queensland and Western Australia have Criminal Codes which are similar to and replace the common law, whereas the Tasmanian Criminal Code differs from those in Queensland and Western Australia in that it leaves much of the common law intact.⁵

4. The *Crimes Act 1900* (NSW), as amended in the ACT by laws of the Territory, applies in the ACT.

5. *Criminal Code 1995* (Qld); *Criminal Code Act 1913* (WA) — The Schedule, The

Criminal Code; *Criminal Code Act 1924* (Tas) — The First Schedule, The Criminal Code.

The Northern Territory's *Criminal Code Act 1983* (NT) largely codifies the criminal law for the Northern Territory and draws its provisions from the Queensland Criminal Code and the draft Criminal Code for Australian Territories. It does not deal with all the criminal law in the Northern Territory, but deals with the more serious offences⁶ and codifies other relevant matters such as criminal responsibility and punishment.

Normally a Criminal Code is interpreted without reference to the pre-existing law unless it carries forward conventional words and phrases expressing general common law principles.

Commonwealth criminal law

Commonwealth law relating to crime is limited to offences relating to its specific constitutional powers (§1-475), such as taxation and other business regulation offences. Commonwealth criminal law has adapted common law principles in the *Crimes Act 1914* (Cth) and many other Commonwealth Acts, such as the *Trade Practices Act 1974* (Cth) and the Corporations Law. The Australian Federal Police force was created in 1957.

Commonwealth criminal law was expanded after Royal Commissions in the 1980s into drugs, tax evasion and white-collar crime reported under-resourcing of law enforcement.⁷ The National Crime Authority was set up in 1984 and the predecessor of the Australian Securities and Investments Commission (ASIC) in 1982 (§9-380).

In a country such as Australia, it is inefficient and unfair to have nine different criminal jurisdictions, since the one action may have different criminal consequences and penalties in the different jurisdictions.

Although the Constitution limits the powers of the Commonwealth to pass national criminal laws (§1-475), the Commonwealth is participating in the work of the Standing Committee of Attorneys-General — representing all governments — which has established a Committee now known as the Model Criminal Code Officers Committee to draft a Model Criminal Code for Australia. The *Criminal Code Act 1995* (Cth), which contains the Code, was passed in 1995. The purpose of the Model Criminal Code is to provide a template to promote harmonisation, rationalisation and codification of Australia's criminal laws.⁸

¶2-040 **Ambit of criminal law.** Criminal law can be classified as:

- (1) offences against public order (such as treason, sedition and unlawful assembly);

6. eg stealing (sec 209, 210), false accounting (sec 233), making false data processing material (sec 276).

7. eg *Mutual Assistance in Criminal Matters Act 1987* (Cth); *Proceeds of Crime Act 1987* (Cth): ¶16-080; *Financial Transaction Reports Act 1988* (Cth): ¶16-080.

8. Chapters 1 and 2 came into force in September 1995, and the Commonwealth intends to have the rest of the Code in force by 2001. The Minister's Second Reading Speech is in *Hansard*, Senate, 30 June 1994. The full text and further details are available on the home page of the Minister for Justice and Customs.

- (2) offences against the administration of the law and against public authority (such as corruption, perjury and destroying evidence);
- (3) acts injurious to the public in general (such as sexual offences, illegal gaming and lotteries);
- (4) offences against the person, and offences relating to marriage and parental rights and duties, and against the reputation of individuals (sexual offences, assaults, homicide, kidnapping and bigamy);
- (5) offences relating to property (stealing, robbery, burglary, miscellaneous frauds, receiving and forgery).

¶2-050 Classification of crime: summary/indictable offences; felonies and misdemeanours. Crimes can be classified under two independent systems of classification:

- summary and indictable offences;
- felonies and misdemeanours.

Summary offences are less serious offences where the question of guilt is determined finally (subject to appeal) by a judicial officer (magistrate or judge). The judicial officer has to determine both the questions of law and the questions of fact arising during the trial. Generally only relatively minor offences such as traffic offences are tried summarily, and many summary offences are offences of strict liability (¶2-010) where it is sufficient for the prosecution to prove (for example) that the defendant pie seller voluntarily sold the contaminated pie.

Indictable offences are those prosecuted by the Crown, tried by judge and jury, where it is the role of the judge to decide issues of law and the jury's role to decide issues of fact, including the ultimate fact of guilt or innocence. Legislatures have also created the indictable offence which can be tried summarily, although this trial may sometimes only occur with the agreement of the accused and/or the magistrate.⁹

The historic difference between *felonies* (the most serious crimes, such as high treason or those usually involving violence such as murder) and *misdemeanours* (less serious crimes) has been abolished or is not used in most jurisdictions. Originally the penalty for a felony was forfeiture of land or goods and death of the felon. All felonies (and some misdemeanours) were indictable and most misdemeanours were summary offences.

9. eg Waller and Williams, *op cit*, para 2.13—2.14; see, eg, *Crimes Act 1900* (NSW) sec 476.

THE CRIMINAL TRIAL

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¶2-110 Purpose of the criminal trial. The purpose of a criminal trial is to decide whether or not the accused person is guilty of the offence charged. A criminal trial is a proceeding where the prosecution (the police, the Director of Public Prosecutions (DPP) or other prosecutor) on behalf of the community assumes the obligations of establishing the charges it laid against the accused by proving beyond reasonable doubt the facts which make up the offence.

The duty of the prosecutor is not to seek conviction at all costs, but to present the case against the accused fairly and honestly. Because a person is innocent until proved guilty, every rule of evidence and procedure in favour of the accused must be honoured, breach of which could lead to a conviction being quashed on appeal.¹⁰

A criminal trial “is not a contest between the Crown’s assertions and the accused’s defences.”¹¹ Unlike trials in some overseas jurisdictions where the trial is of an “inquisitorial” nature, criminal trials under the common law seek judgment through the “adversary” system.

Adversary v inquisitorial systems. The legal process under the adversary system is driven by the parties, not by the judge. The parties run the case.¹²

Under the adversary system, the parties to the proceedings:

- decide which points to raise and how to present them.
- decide which evidence to use.
- put forward their allegations of fact and test the opponent’s allegations of fact.

Under the adversary system, judges:

- do not control the issues to be raised, the inquiries to be made, the evidence to be raised and the witnesses to be called.
- assess the evidence provided by the parties.

10. eg *King v R* (1986) 161 CLR 423 at p 426.

11. *Kirby J in Parker v The Queen* (1997) 71 ALJR 598 at p 623.

12. Brouwer, GEP, *Inquisitorial and adversary procedures — a comparative*

analysis (1981) 55 ALJ 207; Spigelman CJ, *The adversary system* (1998) 72 ALJ 742.

- decide questions of law.
- represent the authority of the state and exercise the judicial power of the state.
- remain impartial, even when the state is a party to the proceedings.
- do not usually ask the questions, though judges may intervene in the trial process and may call witnesses, question them and make management decisions concerning the trial.¹³

The state appears in legal proceedings as a party — such as in the form of the prosecutor, the police or the taxation authority in criminal or enforcement cases or as a litigant in civil cases — but it is equal to the citizen. As a party to the proceedings, the state must conduct its proceedings like any other litigant, and it has no privileges and no special access to the judges, and its right to call witnesses is no different to that of any other litigant.

Court processes. It has been said that justice delayed is justice denied. Judicial administrators are conscious of the need to reduce the time and cost of criminal trials. Increasing computerisation has increased court efficiency, and the introduction in some jurisdictions of videotaped confessions of accused persons has sped up the trial process.

Various other strategies are under consideration to reduce the time of long criminal trials, such as limiting the contested factual and legal issues for adjudication at trial by excluding non-contentious and extraneous matter, and increased pre-trial hearings.¹⁴

Legal aid. The right of the accused to a fair trial in criminal cases may be affected if the accused cannot afford legal representation and does not qualify for legal aid. In these circumstances, the High Court may grant a “stay of proceedings” (an adjournment or postponement of a trial) to avoid a miscarriage of justice.¹⁵ However, “due process” rights such as the right to representation have been foreshadowed by some judges but at this stage they cannot be implied in the Australian Constitution as a “constitutional right”.¹⁶

¶2-120 Role of judge and jury. It is the dual elements of law and fact in any criminal hearing that give rise to the functions of judge and jury. It is the jury’s task to make a decision on which facts are found proved and having done so to determine whether the accused is guilty as charged. In reaching their decision the members of the jury are guided on the law by what the judge has told them of it in the “charge”, ie the address given by the judge to the jury at the conclusion of the trial. Thus the judge is the tribunal of law — the judge determines what the law is — and the jury is

13. Ipp, J, *Judicial intervention in the trial process* (1995) 69 ALJ 365.

14. eg Corns, C, *Anatomy of Long Criminal Trials*, Australian Institute of Judicial Administration, 1997, noted (1997) 71 ALJ 810; (1998) 72 ALJ 109.

15. *Dietrich v The Queen* (1992) 177 CLR 292.

16. *Frugtniet v Victoria* (1997) 71 ALJR 1598.

the tribunal of fact, ie it determines what the facts are and, having done that, determines whether the accused is guilty or not. There is no firm rule of law prohibiting jurors from asking questions of witnesses, but the practice is considered undesirable.¹⁷

A jury is a body of men and women summoned and sworn on oath to decide questions of fact in judicial proceedings. Juries are not required to decide which legal argument is correct. Correspondingly, the judge does not decide innocence or guilt (in criminal trials) or the facts (in civil actions before a jury). It is said that the jury is the principal guardian of truth in the common law.

The jury is assembled by the Sheriff (an officer of the court). Essentially (the details vary from jurisdiction to jurisdiction), a list of electors is provided to the Sheriff by the Electoral Office, from which names are selected at random, usually by computer, to serve as jurors. The Sheriff then sends out questionnaires to those names supplied, to ascertain which of them is qualified for jury service. Each of the Juries Acts¹⁸ lists those disqualified,¹⁹ ineligible²⁰ and exempt²¹ from service. From those prospective jurors obliged to do jury service the Sheriff summons the numbers necessary to constitute panels from which actual juries will be chosen (empanelled).

Juries are used in criminal trials for indictable offences (§12-050) in the superior and intermediate courts and in some civil cases. The use of juries in civil actions has been virtually abolished in all jurisdictions and civil actions are generally heard by judge alone. Even where civil juries are possible, a party may not be entitled to a jury hearing unless proceeding in the superior and intermediate courts and where no equitable principles are involved and the claim does not involve compensation for personal injuries suffered as a result of a motor vehicle accident.

Advantages of juries. Juries are an independent buffer between the people and the legal system, ensuring that the legal system does not become too “legalistic”, and providing the community with participation in the legal process. From the first years in the then convict colony of New South Wales, juries have been regarded as a constitutional necessity for the trial of serious criminal offences.²² Juries provide a safeguard against possible

17. *Lo Presti v The Queen* (1994) 68 ALJR 477.

18. eg *Juries Act 1967* (Vic); *Jury Act 1977* (NSW); *Jury Act 1995* (Qld); *Juries Act 1927* (SA); *Jury Act 1899* (Tas).

19. Essentially, all persons with a conviction, ranging from a conviction for treason to persons disqualified from holding a driver's licence for more than six months, eg *Jury Act 1977* (NSW) Sch 1; *Juries Act 1967* (Vic) Sch 2; *Jury Act 1995* (Qld) sec 4.

20. eg judges, MPs, lawyers, police, various public servants, people who are unable

to read or understand English, eg *Jury Act 1977* (NSW) Sch 2; *Juries Act 1967* (Vic) Sch 3; *Jury Act 1995* (Qld) sec 4(3).

21. eg those who may claim exemption as of right include doctors, pregnant women, pharmacists, those over 65, eg *Jury Act 1977* (NSW) Sch 3; *Juries Act 1967* (Vic) Sch 4.

22. Castles, AC, *The unmarked bicentennial of jury usage in Australia and some consequences of its decline* (1990) 64 ALJ 505.

abuse of judicial power and by so doing may render current legal standards more acceptable to the community.

Disadvantages of juries. Juries are expensive, and unrepresentative of the community. They cannot always understand the legal process or even the facts (eg in white-collar crime offences), and they may be swayed by personal and public opinion. In assessing compensation in civil actions, juries may have insufficient understanding of the amounts or comparative data. Juries tend to narrow the range of bargaining by overcompensating for small injuries and undercompensating for large injuries.

¶2-130 Preliminary investigation/committal. If the accused is charged with a summary offence then the date which has been set for the accused's return to court will be for hearing the charge, but if the accused has been charged with an indictable offence there will be a preliminary hearing, ie an inquiry to establish whether there is a *prima facie* case against the accused. The prosecution will present its evidence and the accused will have the chance to cross-examine and question, but will not be required to present a defence at this point. At the conclusion of these proceedings the judge or magistrate will determine if there is enough evidence for the accused to stand trial on.

¶2-140 The parties to criminal proceedings. The person presenting the case on behalf of the police is called the prosecutor. Some jurisdictions have a branch of police officers specialising in prosecuting.

The burden of proof of criminal liability is proof beyond reasonable doubt. (The civil law burden of proof is proof on the balance of probabilities.)

In higher courts, control of the prosecution case is passed from the police to a legal officer of a department under the control of the Attorney-General or the Director of (Public) Prosecutions, often called "the Crown". Sometimes the Crown will brief an independent barrister to prosecute, but more usually the prosecutor is one of the permanent Crown Prosecutors.

If the accused has been arrested and granted bail the accused must appear on the date for the trial or be guilty of a separate offence of breaking a condition of bail, ie failing to appear for trial. If it has not been necessary to arrest the accused, the accused will be served with a summons which requires appearance on a given date to answer the charges.

The accused has the right either to be represented in court by a solicitor or barrister, or to go to court unrepresented. The benefit of legal representation cannot be overlooked. One classic study analysed the results of 28,816 documented local court cases in New South Wales.²³ One in three

23. Vinson, T and Homel, R, *Legal representation and outcome* (1973) 47 ALJ 132.

defendants was legally represented, and an analysis showed that the person represented had a six-and-a-half times better chance of securing an outright favourable judgment than a person unrepresented. The figures also showed that the unrepresented were three times more likely to be sent to prison, that three-quarters of those found not guilty were legally represented, and that nine out of ten of those sent to prison were unrepresented.

¶2-180 The trial. First the prosecution opens its case by calling its witnesses and other evidence to prove its case. This has the additional function of allowing the accused person to know the details of the case which the prosecution wishes to prove at trial. Then the accused calls evidence by way of defence. Very rarely the prosecution may be able to call more evidence. Counsel (ie barristers) on either side will make closing addresses to the jury and the judge will sum up, instruct the jury on the legal rules it should apply in arriving at its decision, identify the facts in issue, focus on the more significant items of evidence and relate them to the issues; the judge may also direct the jury that it must acquit an accused because of lack of evidence.

Following the judge's charge to the jury, the jury retires to consider its verdict. At common law the verdict must be unanimous, but under statute in some jurisdictions juries can return majority verdicts,²⁴ thereby avoiding expensive retrials when one or two jurors only will not join with the majority.

By an order of the court, the successful litigant in civil proceedings is normally entitled to a refund of legal costs from the unsuccessful party. In contrast, there is no general rule in summary proceedings of a criminal nature that "costs follow the event". However, following a "radical and controversial" judgment of the High Court in 1990,²⁵ a successful defendant would now be likely to obtain an order for costs against the prosecution where the charges have been dismissed.

¶2-190 Appeals. A person convicted of a criminal offence may appeal from the conviction to a higher court (¶1-170). Appeals from Magistrates' Courts (summary offences) may sometimes be taken to an intermediate court, although generally all criminal appeals (including those from magistrates) involving questions of law are taken to the Supreme Court. The Crown has only a limited right of appeal against the decision of a jury, but where an accused appeals successfully the Crown may then appeal against that decision. It may also appeal against sentence. A further appeal can be made to the High Court if the High Court gives leave to appeal, for example if the case has some special feature.

24. *Juries Act 1927* (SA) sec 57(4) (10 out of 12); *Juries Act 1957* (WA) sec 41 (10 out of 12) with some qualifications. Unanimity of jurors became firmly established in England in 1367, and statutory inroads have been only peripheral to this principle. A unanimous

verdict of jurors is required in a trial of an indictable offence under Commonwealth law: *Cheatle v The Queen* (1993) 177 CLR 541.

25. *Latoudis v Casey* (1990) 170 CLR 534; (1990) 65 ALJR 151, noted (1991) 65 ALJ 187.

¶12-200 Sentencing and penalties. The penalties that can be imposed by a court upon conviction reflect the criminal law's aims of retribution, deterrence, incapacitation and reformation (¶12-020). Responsibility for imposing penalties — sentencing — is balanced between the three branches of government (¶1-475): the legislature, influenced by and answerable to the electorate, lays down maximum and minimum penalties; the judiciary, in response to the scope of the prosecution brought, fixes a penalty within the range available, while through corrective services staff the executive branch of government, accountable to the electorate through the system of ministerial responsibility, determines the place, conditions and circumstances of any loss of liberty which may be imposed.

A penalty should be no greater than is necessary to achieve the object of compliance with the relevant legislation. A penalty which will be a deterrent to a poor person or to a small company may not be a deterrent to a wealthy person or to a large company.

Penalties range in severity from a warning (for example, for young offenders in the Children's Court), imprisonment until rising of the Court,²⁶ imprisonment and confiscation of criminal profits (¶16-080), to life imprisonment.²⁷ Fines are the most common sanction, ranging from a nominal penalty,²⁸ to \$10 million for breaches of Part IV of the *Trade Practices Act 1974* (Cth) (¶8-770).

There is increasing emphasis on reform and rehabilitation of offenders, and a number of alternatives to imprisonment exist such as weekend and daily attendance centres, early release schemes, pre-discharge temporary leave, and remissions. Several jurisdictions provide for the avoidance of prison altogether for lesser and first-time offenders by means of good behaviour bonds, probation and treatment (especially relevant for drug offenders) to ensure that offenders are given an opportunity to change their ways rather than be confined to prison along with hardened offenders where the chances of being influenced and returning to prison are great.

Forfeiture rule. Under the forfeiture rule, a person convicted of a crime cannot normally get any benefit from the crime.²⁹

Confiscation of criminal profits. Judging by the ever increasing rise in the incidence of lucrative forms of business crime, white-collar crime and especially drug-related crime, the traditional penalties imposed by the law are sometimes inadequate to punish and deter. Even imprisonment for long

26. eg *R v Knowles*, Supreme Court of Victoria, 24 September 1984, noted (1985) 9 Crim LJ 57.

27. Formerly the *Crimes Act 1958* (Vic) provided for death in sec 3. With the abolition of the death sentence, the section now provides for life imprisonment. cf *Crimes Act 1900* (NSW), eg, sec 19A "penal servitude for life" (for murder).

28. eg \$10 for breach of sec 45A of the *Trade Practices Act 1974* (Cth) (¶8-110) in *Trade Practices Commission v Axive Pty Ltd* (trading as *Newcastle Ice & Cold Storage*) (1994) ATPR ¶41-368.

29. eg *Forfeiture of benefit under will by killer* (1998) 72 ALJ 357 (rule not applied to a convicted killer).

periods fails as a deterrent if large amounts of criminally derived profits await the offender upon release. The law is now fighting back by means of the freezing of assets, the confiscation of the criminal profits of any person convicted of an indictable offence, and penalties designed to reduce the economic power of criminals and their enterprises by ensuring that they are stripped of their ill-gotten gains.³⁰ Property used in or in connection with the commission of a serious offence, any property derived or realised by anyone as a result of a serious offence and any property in the possession of the defendant during or immediately after the offence is presumed to be "tainted property" and is liable to forfeiture after the offender is convicted. Pecuniary penalties can also be imposed as an equivalent to benefits gained from crime which cannot be traced to specific assets. Confiscation remedies polarise opinions: on the one hand, forfeiture orders can be seen as too broad (especially where innocent third parties' property rights are involved), unjust or unnecessary, while restraining orders can encourage "fishing expeditions" by the state for the gathering of information and evidence contrary to basic civil liberties; on the other hand, such laws, with expert back-up and enforcement, can be seen as a natural response to counteract complex measures taken especially by well organised criminals and criminal groups.

— *Case example* —

One of the major property developers found guilty when prosecuted by the Office of the Special Prosecutor in Queensland for official corruption was ordered to pay \$500,000 to the Crown under the *Crimes (Confiscation of Profits) Act 1989* (Qld).

*Annual Report of the Special Prosecutor*³¹—

Parole Boards. Parole Boards in each of the States have power to release prisoners on licence and supervise their behaviour until the period of their sentence has expired.

Penalties and sentences reform. The authority to impose penalties is based in numerous legislative provisions, and because these are not always co-ordinated, the sentencing process and the administration of corrective services is frequently criticised by judges, politicians, police and social workers for alleged discrepancies and uneven treatment, adding further fuel to claims of a "crime problem". Many jurisdictions consolidate sentencing decisions to provide judges and magistrates with precedents and assistance in the exercise of their discretions.³² Some jurisdictions have sought to give effect to recommendations of the Australian Law Reform Commission's Report on

30. eg *Proceeds of Crime Act 1987* (Cth); 1991 (ACT); *Confiscation of Proceeds of Crime Act 1989* (NSW); *Crimes (Confiscation of Profits) Act 1986* (Vic); 1986 (SA); 1988 (WA); 1989 (Qld); *Crime (Confiscation of Profits) Act 1993* (Tas); *Crimes (Forfeiture of Proceeds) Act 1988* (NT); ¶16-080.

31. For the year ended 31 December 1991, Brisbane, p 7.

32. eg Spigelman, Chief Justice JJ, *Sentencing guideline judgments* (1999) 73 ALJ 876.

the *Sentencing of Federal Offenders*,³³ which recommended reducing the emphasis on imprisonment as a sanction for criminal offences and ensuring greater use of non-custodial sanctions, increasing “truth in sentencing” by ensuring that offenders actually serve the sentence (or most of it) handed down by the court, and encouraging courts to adopt a more structured and consistent approach to fixing sentences. The sentencing legislation answers critics who argue that the judiciary has excessive discretionary powers in sentencing, by requiring disclosure and accountability in the form of written reasons by the judiciary on imposing a prison sentence.

Compensation for crime. Whereas the criminal justice system once clearly supported the principle of retribution, and seriously sought compensation for the victim of crime, the development of the notion of crime as a wrong against the state rather than the individual seems to have overlooked the plight of the victim. Each State and Territory now has a system of criminal injuries compensation, providing compensation for personal injury or death; claims under the schemes should generally be made to the court or to the Crimes Compensation Tribunal or equivalent (see ¶1-160).

WHO CAN COMMIT CRIMES? _____

Children ¶2-210
Corporations ¶2-220
Public officers ¶2-230

¶2-210 Children. At common law children under the age of seven were considered incapable of committing crimes, as they were presumed to be unable to form the necessary intent. This age has now been confirmed or varied by statute in the various jurisdictions.³⁴ From this age to 14 a child can be convicted of a crime only if, in addition to proof of the necessary intent, it can be shown that the child knew that the act in question was wrong.³⁵ This requirement is usually satisfied by the prosecution’s giving evidence that the child admitted knowing that the act was wrong. There is

33. ALRC, Report No 15, *Sentencing of Federal Offenders*, AGPS 1980; ALRC, Report No 44, *Sentencing*, 1988. See, eg, *Sentencing Act 1989* (NSW); 1991 (Vic); *Penalties and Sentences Act 1992* (Qld); *Penalty Units and Other Penalties Act 1987* (Tas); *Pessimism on new sentencing laws* (1997) 71(7) LIJ 10; Attorney-General’s letter in reply (1997) 71(10) LIJ 7.

34. eg *Crimes Act 1914* (Cth) sec 4M (age 10) (added 1995); *Criminal Code Act 1995* (Cth) sec 7.1 (age 10); *Children and*

Young Persons Act 1989 (Vic) sec 127 (age 10); *Children (Criminal Proceedings) Act 1987* (NSW) sec 5 (age 10); *Criminal Code* (Qld) sec 54 (age 10); *Criminal Code* (WA) sec 29 (age 10); *Criminal Code* (Tas) sec 18 (age 7). “So far as I am aware, there has never been a prosecution of a child under 14 for murder in the whole of Australian history”: Turner, JN, *The James Bulger case* (1994) 68 LIJ 734 at p 737.

35. *The criminal liability of children* (1995) 69 ALJ 593.

good evidence that children from as young as six can make reliable witnesses in court.³⁶

¶2-220 Corporations. Corporations can present problems to the criminal law as they lack both a physical body which can stand in the dock or be sentenced to imprisonment and (as was thought for many years) a mind that can form the necessary criminal intent. The current position is that a corporation will be liable for the criminal acts of its officers or employees done in the scope of their authority to transact the company's affairs if it can be shown that those acts were in fact the acts of the corporation (ie that the human responsible was sufficiently senior in the company's management for the criminal conduct to be able to be viewed as that of the company).³⁷ Only in specific areas such as trade practices law can a corporation itself be convicted.

Further, the Acts Interpretation Acts (¶9-270) define "person" to include a corporation. Procedural difficulties concerning corporations are now overcome by statute in most jurisdictions, by providing that a corporation can be represented in court by its representative (meaning a person appointed by the corporation to represent it).³⁸

¶2-230 Public officers. There is no immunity from criminal prosecution for persons holding public office, such as judges, magistrates, etc. Members of Parliament are subject to the criminal law, and the privileges of Parliament do not apply to criminal matters. The only persons exempt from the criminal jurisdiction of the courts are the sovereign and foreign sovereigns, ambassadors and diplomatic staff. All these exemptions have been established for many centuries but have not allowed Crown servants to claim the sovereign's immunity from prosecution for their criminal acts.

WHITE-COLLAR AND BUSINESS CRIME

The problem	¶2-240
Classification of white-collar crime	¶2-250
Catching the white-collar criminal	¶2-270
Computer crime	¶2-300

¶2-240 The problem. White-collar crime was first defined in the 1940s as "crime committed by a person of respectability and high social status in the course of his occupation".³⁹ Another definition describes it as "fraud and embezzlement ... linked to the characteristics of the offenders, namely older, educated persons of previous good character and above average wealth, whose crimes are non-violent and involve manipulations within the

36. Oates, RK, *Children as witnesses* (1990) 64 ALJ 129.

37. *Trade Practices Act 1974* (Cth) sec 84 (for proceedings under that Act: ¶8-760).

38. eg *Australian Securities and Investments Commission Act 1989* (Cth) sec 59(6) ("Proceedings at hearings").

39. Sutherland, EH, *White Collar Crime*, New York, Holt, Rinehart and Winston, 1961, p 9.

financial and corporate sectors.”⁴⁰ The subject continues to attract public attention, but the effects and scope of white-collar crime are still largely uncharted. The sums of money involved are sometimes very large.

¶2-250 Classification of white-collar crime. A useful classification of white-collar crime has been made by American criminologist Edelhertz which, by listing the scope of activities considered “white-collar”, indicates the exact nature of the crime. The classification is based on lines of motivation, as follows:⁴¹

- (1) Crimes by persons operating on an individual, ad hoc basis, for personal gain in a non-business context.
- (2) Crimes in the course of their occupations by those operating inside business, government, or other establishments, or in a professional capacity, in breach of their duty of loyalty and fidelity to employer or client.
- (3) Crimes incidental to and in furtherance of business operations, but not the central purpose of such business operations.
- (4) White-collar crime as a business, or as the central activity of the business.

¶2-270 Catching the white-collar criminal. A large number of offences that are classified as white-collar involve complex business situations with many interconnecting transactions. The obvious consequence of this complexity in committing them is the complexity of unravelling them. Law enforcement agencies are quite often confronted with problems which need the skill and knowledge of experienced accountants and lawyers for detection, investigation and prosecution.

There are further factors limiting prosecution and detection by the law enforcement agencies. First, there is the difficulty of obtaining and presenting the evidence necessary to secure a conviction. Australia remains one of those countries where one is innocent of an offence until proved guilty and, although it may be “obvious” that X’s company has failed and that \$2m is missing, to prove that X took it is quite another matter. Or, while it may be obvious that creditors and shareholders have lost money, it may be difficult to prove in law that the loss resulted from a criminal act. Indeed there may be no criminality; the loss may have resulted from bad business judgment.

Secondly, if nobody knows the crime has taken place, how can it be reported and investigated? Often this type of crime can only be revealed by “peers” because no one else will have access to the information necessary. A conventional profit and loss statement or balance sheet may not reveal missing funds beyond perhaps a decrease in fixed assets; an audit may detect irregularities, but a successful operator will leave no traces of financial

40. Devlin, SP, *White collar crime* (1990) 64 LJ 859 at p 859.

enforcement agencies, US Dept of Justice, 1977, pp 27-30.

41. Edelhertz, H, *The Investigation of White Collar Crime — A manual for law*

movements. If the crime has been “successful” there will be no complainant to report it. Tax evasion serves as an illustration — by definition the tax is evaded, and therefore it is not detected. Perhaps loss of revenue may indicate evasion at work, but there will be no evidence of where, when and how. The police officer on the beat patrolling the streets to detect non-reported crimes also operates as a deterrent, but what is the effectiveness of the deterrents to white-collar crime?

Effective national and international enforcement of laws against white-collar crimes requires co-operation and reciprocal arrangements between Australia’s Commonwealth, State and Territory based law enforcement agencies and between Australian and overseas agencies. The commencement of the Australian Securities Commission in 1991 (now the Australian Securities and Investments Commission), and legislation for mutual assistance in criminal matters and in business regulation, marks some of the 1990s’ regulatory response to the white-collar crime excesses of the 1980s which were in part caused by inadequate regulation.⁴²

¶2-300 Computer crime. The recognition of the phenomenon of computer crime surfaced in the 1970s with the development of computerisation:

- in the *Equity Funding case* in the US in the early 1970s, \$2.5 billion was stolen by computer from an insurance company through fictitious policies and claims;⁴³
- an accounts payable supervisor was able to authorise the establishment of new suppliers and process copy invoices and adjustments, thereby causing cheques to be drawn in favour of accounts the supervisor had established;
- a direct mail supervisor was able to put in orders and make adjustments to unpaid accounts, thus obtaining free goods.

Billions of dollars are transmitted electronically every day, thereby providing challenges to the computer hacker — “the postmodern electronic equivalent of the cowboy and the mountain man”⁴⁴ — and it is only a matter of time before major infiltration of transmission by thieves and terrorists occurs. But computers can readily fight crime as in the bottom-of-the-harbour prosecutions in the early 1980s and the work of the National Crime Authority. The Australian Securities and Investments Commission’s national corporate computer database (ASCOT) holds key information submitted by all

42. eg *Mutual Assistance in Criminal Matters Act 1987* (Cth), noted (1989) 63 ALJ 6. It is complemented by the *Mutual Assistance in Business Regulation Act 1992* (Cth) (which authorises the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission to provide reciprocal assistance in collecting information documents and sworn

testimony for equivalent overseas agencies).

43. See, eg, Soble, RL and Dallos, RE, *The Impossible Dream — the Equity Funding Story: the fraud of the century*, New York, Putnam, 1975.

44. Sterling, B, *The Hacker Crackdown*, Penguin Books, 1992, p 54. See generally Grabosky, PN and Smith, RG, *Crime in the Digital Age*, Federation Press, 1998.

companies, and its database for storing electronic images of all documents submitted (DOCIMAGE) allows full document retrieval (§19-380). The links in policing now occurring between regulators in Australia and overseas are important in tracking computer and business crime (§12-270).

Computer crime laws. Until computer crime laws were passed in most jurisdictions in the late 1980s/1990s, computer criminals were rarely detected and caught.

Computer abuse can take two forms — where the computer is the *target* of criminal activity, and where the computer provides the *tool* of criminal activity:

- (1) As target or victim of criminal activity, the computer has always been legally protected by criminal sanctions for such offences as arson and wilful or malicious damage.⁴⁵
- (2) There are now a number of specific computer crime laws in place to deal with the situation where the computer is the tool of or means of committing criminal offences:
 - (a) the major fraud offences such as dishonestly obtaining money, a valuable thing, property or financial advantage by deception have been amended in most jurisdictions to ensure that deception includes not only deceiving a person but also deceiving a computer system or machine (such as an ATM) by causing it to make an unauthorised response.⁴⁶
 - (b) falsifying documents. Criminal laws have been amended to extend the offence of falsification of articles (previously only written documents) to include falsification of computer-stored data, computer-related articles (such as disks and tapes) and credit cards and ATM cards.⁴⁷
 - (c) unlawful access/hacking/computer trespass. In addition to the offences outlined in (b) above involving criminal intent and harmful consequences, criminal laws in many jurisdictions have been amended to criminalise hacking and other forms of gaining unauthorised access to computer systems by breach of a security access code.⁴⁸ Hacking is also

45. eg *Crimes Act 1958* (Vic) sec 197; *Crimes Act 1900* (NSW) sec 194, 201; *Criminal Code* (Qld) sec 190; *Criminal Code* (WA) sec 441-443, 455; *Criminal Code* (Tas) sec 267-269.

46. eg *Crimes Act 1914* (Cth) sec 63(3); *Crimes Act 1900* (NSW) sec 178BA(2); *Crimes Act 1958* (Vic) sec 81(4); *Criminal Code* (Tas) sec 257B.

47. eg *Crimes Act 1914* (Cth) sec 76C, 76E; *Crimes Act 1900* (NSW) sec 310; *Crimes Act 1958* (Vic) sec 83A; *Criminal Code* (WA) sec 443; *Criminal Code* (Tas) sec

257C, 257E; *Crimes Act 1900* (NSW), in its application to the ACT, sec 135A-135F; *Criminal Code* (NT) sec 276.

48. eg *Crimes Act 1914* (Cth) sec 76B, 76D; *Crimes Act 1900* (NSW) sec 309; *Summary Offences Act 1966* (Vic) sec 9A; *Criminal Code* (Qld) sec 173-175; *Summary Offences Act 1953* (SA) sec 44; *Criminal Code* (WA) sec 440A; *Criminal Code* (Tas) sec 257D; *Crimes Act 1900* (NSW) in its application to the ACT, sec 135H-135L. See further "Hacking" into computer systems (1990) 64 ALJ 105.

actionable as a civil wrong under the tort of trespass. Hacker attacks on AOL and Yahoo websites have highlighted the need for the criminal law to address the actions of those who intentionally impair electronic communications to or from a computer without authorisation. The Model Criminal Code (¶2-030) proposes to target “denial of service attack” under the “unauthorised impairment of electronic communication” offence.⁴⁹

— *Case examples* —

A 31-year-old Victorian computer programmer, who copied from his employers the source code for a financial accounting system valued at \$1.5m, has become the first person convicted of computer trespass and fined under the *Summary Offences Act 1966* (Vic) sec 9A for accessing a computer system without authorisation.

*R v Belkin*⁵⁰ —

A staff member in the information systems department of a bank who made unauthorised withdrawals from his ATM by taking it “off host” (off the main computer) without authority was convicted of computer trespass.

*Director of Public Prosecutions v Murdoch*⁵¹ —

Traditional offences such as theft (¶2-320—¶2-340),⁵² forgery,⁵³ burglary,⁵⁴ breach of copyright,⁵⁵ telecommunications offences,⁵⁶ and those contained in the Corporations Law⁵⁷ provide further penalties, and criminal law cases such as *Kennison v Daire* (¶2-330) confirm the ability of the legal system to deal with offences committed by the use of computer technology. But the problems of policing, detection and prosecution remain.

49. Senator Amanda Vanstone, Media release 19/2000.

50. Noted in *Compulaw Review*, LSJ, Vol 28, No 6, p 89 (July 1990).

51. [1993] 1 VR 406.

52. eg *Duramco Software Pty Ltd v Coniglio*, Supreme Court of Western Australia, unreported, April 1986; theft of electricity: eg *Electricity Act 1978* (NT) sec 29.

53. eg *Crimes Act 1914* (Cth). “Forgery” as defined in sec 63 would cover alteration of computer records; *Criminal Code* (WA) sec 473.

54. eg *Crimes Act 1958* (Vic) sec 76; *Crimes Act 1900* (NSW) sec 109ff; *Criminal Code*

(Qld) sec 170; *Criminal Code* (WA) sec 401.

55. The amendment in 1984 of the definition of “literary work” in the interpretation section (sec 10) of the *Copyright Act 1968* (Cth) now includes “a computer program, or compilation of computer programs” (¶3-500; ¶3-505).

56. *Telecommunications (Interception) Act 1979* (Cth).

57. eg Corporations Law sec 1307(2); does Corporations Law sec 1306(3) requiring a company to protect the books required by the Law oblige a company to protect itself from computer hackers?

OVERVIEW OF WHITE-COLLAR OFFENCES

White-collar offences	¶2-310
Theft and larceny	¶2-320
Theft at common law (all jurisdictions except Victoria, ACT, NT)	¶2-330
Theft in Queensland, Western Australia and Tasmania	¶2-335
Theft in Victoria, ACT, NT	¶2-340
Further white-collar offences	¶2-350
Embezzlement	¶2-360
Fraudulent conversion	¶2-370
False accounting	¶2-380
Frauds by factors and other agents	¶2-390
Frauds by other persons in business	¶2-400

¶2-310 White-collar offences. Many white-collar offences are already covered in the criminal law legislation in the various States and Territories dealing with larceny, theft, embezzlement, obtaining property or financial advantage by deception and false accounting. Most of these offences are of ancient origin, and centuries of narrow technical definition by the courts have added many complications to their operation.¹

In addition, white-collar offences are scattered through dozens of Acts: the Corporations Law, the *Income Tax Assessment Act 1936* (Cth), the *Trade Practices Act 1974* (Cth), pure food and drug law, weights and measures legislation, consumer law and environmental law. Some white-collar offences are dealt with in the civil courts, for example in cases dealing with conspiracy, conversion (¶4-020) and liability for breach of fiduciary obligations (¶9-770) including secret commissions.

¶2-320 Theft and larceny. Theft law is covered differently in each of the jurisdictions:

- New South Wales and South Australia retain the common law of larceny supplemented by a number of statutory offences.
- Queensland, Western Australia and Tasmania have Criminal Codes (¶2-030) which define stealing in general terms reproducing the common law. The definitions are extended to cover a number of further situations.
- Victoria, the ACT and the Northern Territory have substantially re-enacted the *Theft Act 1968* (UK), described as a comprehensive well-drafted code designed to meet the needs of a modern commercial society. At least one study of the subject concluded that the *Theft Act*

1. One reason for this, in the case of theft, was theft's origin as a felony, which was "capital", ie punishable by death, with

courts tending to interpret its operation narrowly in the interests of the rights and freedoms of the accused.

“could, with suitable amendments, serve as a model for adoption in each of the Australian jurisdictions”.²

¶2-330 Theft at common law (all jurisdictions except Victoria, ACT, NT). The crime of simple larceny (commonly called theft or stealing) exists as a common law offence (ie defined by case law) in New South Wales and South Australia. Queensland, Western Australia and Tasmania define stealing and like offences in their Criminal Codes (¶2-335), while Victoria, the Australian Capital Territory and the Northern Territory have adopted the English approach of a single plain English offence of “theft” (¶2-340).

At common law, a person steals if

- (1) without the consent of the owner, that person
- (2) fraudulently and
- (3) without a claim of right made in good faith,
- (4) takes and carries away
- (5) anything capable of being stolen belonging to another
- (6) with intent at the time of taking to permanently deprive the owner of it.

Each of these elements is illustrated below:

— *Case examples* —

(1) *Without the consent of the owner*

Middleton (M) sought to withdraw 10/- from his savings account which had a credit balance of 11/-. By mistake, the clerk paid him £8-6-10, and M, aware of this mistake, took the money with the intent to steal it. At his trial the jury found that M intended to steal when he took the money from the counter, and he was convicted of larceny. The conviction was confirmed on appeal by a majority of eleven judges to four, of which seven of the eleven in a joint judgment held that because the clerk’s mistake prevented property in (or ownership of) the money passing, and because M had the intent to steal at the moment of the taking, he was guilty of larceny.

— *R v Middleton*³ —

Ashwell (A) asked V to lend him a shilling. By mistake, V in the dark handed A a coin which each believed to be a shilling. At first A did not realise the mistake, but when he later discovered it was a sovereign, A appropriated the coin. He was later convicted of larceny.

— *R v Ashwell*⁴ —

The basis of these two judgments has been often debated. *Middleton* can only be explained on the basis that there was a taking against the consent of the owner when M received the money, and that he therefore acquired neither the right to possession nor ownership of it. The clerk’s apparent consent was

2. Williams, CR, *Property Offences*, LBC, 3rd ed, 1999, p 1.

3. (1873) LR 2 CCR 38.

4. (1885) 16 QBD 190.

overcome by mistake. *Ashwell* rests on the proposition that the mistake of A and V meant that A did not acquire possession of the sovereign (although he had obtained physical possession) until he realised that the coin was a sovereign. At that time, he formed an intention to keep it, and was therefore held to have taken it without consent.⁵

— *Case examples* —

Some four months after the closure of his account, and knowing that there were no funds to his credit and that he had no authority to do so, D inserted his card into his bank's Automatic Teller Machine (ATM), keyed in his authentic personal identification number (PIN) and withdrew \$200. This amount was paid because the ATM was temporarily not on-line to the bank's central computer and the command could not be verified. The fact that the ATM was programmed to pay up to \$200 when off-line was rejected as evidence of consent by the bank to the taking when there were no funds in the account, and D was convicted of simple larceny.

*Kennison v Daire*⁶ —

(2) *Fraudulently*

A shop manager was in the habit of taking money from the till and replacing it with a valid cheque. One Saturday he took £50 from the employer's till, intending to repay it on the following Monday with a cheque from his daughter. He was dismissed on the Monday for reasons not relating to these facts and was subsequently charged and convicted of larceny of the money he had taken. It was said that the hope and intention to repay or replace is insufficient, because the larcenous person in taking something to which he is not entitled without the consent of the owner is in effect trying to force an unauthorised substitution on the owner.

*R v Cockburn*⁷ —

(3) *Without a claim of right*

Clayton, who was living apart from his wife, took money from her purse for an alleged debt. Because it was proved that he had a genuine belief in his right to the money the conviction was quashed.

*R v Clayton*⁸ —

(4) *Taking and carrying away*

Bloxham was a council employee. He took a buyer to council premises to show her a fridge which he represented to be his and agreed to sell it to her. The fridge was not collected or delivered, and when he was charged with larceny, it was held that because there had been no attempt to move it, there had been no "taking" and therefore no larceny.

*R v Bloxham*⁹ —

5. *Middleton* was rejected in *R v Potisk* (1973) 6 SASR 389, and doubts have been cast on it in *Ilich v R* (1987) 162 CLR 110. It is supported by many commentators, eg Lanham, D et al, *Criminal Fraud*, The Law Book Co Ltd, 1987, pp 50-51.

6. (1986) 160 CLR 129 (*Criminal Law Consolidation Act 1935* (SA) sec 131), noted

in *Computers and Law*, Australian Accountant, Vol 56, No 4, p 62 (May 1986).

7. [1968] 1 All ER 466.

8. (1920) 15 Cr App R 45.

9. (1943) 29 Cr App R 37.

(5) *Anything capable of being stolen (ie tangible personal property)*

A void cheque has been held to be capable of being stolen,¹⁰ but not a document of title to realty¹¹ (on the basis that things forming part of land, or to do with land or real property, are not the subject of larceny). This rule is typical of the way in which modern larceny law has had to be updated by statutory initiative.¹²

An undergraduate engineering student at Liverpool University dishonestly obtained the proof copy of the forthcoming civil engineering examination and then returned it after reading its contents. Because the student did not intend to steal the actual physical paper, he was charged under the *Theft Act 1968* (UK) by the university authorities with theft of confidential information (ie the meaning of the words printed on the paper as opposed to the paper itself and the characters printed on it). This cheating was condemned by the judge, but the criminal charge failed on the ground that there was no appropriation of “property”.

_____ *Oxford v Moss*¹³—

Highlighting the inadequacy of the law of theft to deal with computer crime (§2-300), an action by D alleging P had “stolen” software owned by D by copying it — not by physically removing disks or diskettes — failed on the basis that P’s actions “could not in fact amount to stealing within the [law of theft] as the copying of programs could not be the taking of something capable of being stolen”. How can property be stolen when the property (the disk) is left behind?

(6) *With intent to permanently deprive the owner thereof*

The defendant used a horse belonging to someone else and left it at an inn 50 km away. It was held that larceny had not been committed because there was no intention on the defendant’s part to change the property or to make it his own.

_____ *R v Phillips and Strong*¹⁴—

A cheque issued by the Ministry of Food intended for L Hudson, but payable to “Mr Hudson” was delivered to J Hudson. J Hudson returned the cheque, informing the Ministry that his initial was “J”, whereupon the Ministry inserted the initial “J” to the payee’s name and returned the cheque. The court accepted that at the time of the receipt of the envelope containing the cheque, J Hudson had no intent to steal, but at the moment he discovered the cheque, clearly belonging to someone else, he formed the intent to steal it and thereby completed the offence of larceny.

_____ *R v Hudson*¹⁵—

10. *R v Perry* (1845) 1 Car & K 726; 174 ER 1008.

11. *R v Westbeer* (1739) 1 Leach 12; 168 ER 108.

12. *Crimes Act 1900* (NSW) sec 4 “valuable security”; *Criminal Law Consolidation Act 1935* (SA) sec 145.

13. (1978) 68 Cr App R 183.

14. (1801) 2 East PC 662.

15. [1943] 1 KB 458.

The law of larceny, as evolved over the centuries, is considered to be a notoriously idiosyncratic head of criminal liability, full of anomalies such as the following:

- the requirement that removal of property by the accused amount to a (tortious) trespass, ie that it be taken without the consent of the possessor;
- the requirement that the asportation (the physical act of removal) and formation of *mens rea* of larceny (*animus furandi* — the intention of stealing) occur simultaneously;
- larceny at common law is confined to specific, physical things, and money in a bank account (a debt) cannot be the subject of larceny.

¶2-335 Theft in Queensland, Western Australia and Tasmania. Stealing and related offences are defined in the Criminal Codes in the three Code jurisdictions of Queensland, Western Australia and Tasmania (¶2-030).¹⁶

For example, theft is defined in the Western Australian Code as follows:¹⁷

“Definition of stealing.

371(1) A person who fraudulently takes anything capable of being stolen, or fraudulently converts to his own use or to the use of any other person any property, is said to steal that thing or that property.

371(2) A person who takes anything capable of being stolen or converts any property is deemed to do so fraudulently if he does so with any of the following intents, that is to say:—

- (a) An intent to permanently deprive the owner of the thing or property of it or any part of it;
- (b) An intent to permanently deprive any person who has any special property in the thing or property of such special property;
- (c) An intent to use the thing or property as a pledge or security;
- (d) An intent to part with it on a condition as to its return which the person taking or converting it may be unable to perform;
- (e) An intent to deal with it in such a manner that it cannot be returned in the condition in which it was at the time of the taking or conversion;
- (f) In the case of money, an intent to use it at the will of the person who takes or converts it although he may intend to afterwards repay the amount to the owner.

16. *Criminal Code 1995* (Qld); *Criminal Code Act 1913* (WA) — The Schedule, The Criminal Code; *Criminal Code Act 1924* (Tas) — The First Schedule, The Criminal Code.

17. *Criminal Code* (Qld) sec 155-158; *Criminal Code* (WA) sec 371; *Criminal Code* (Tas) sec 226.

The term “special property” includes any charge or lien upon the thing or property in question, and any right arising from or dependent upon holding possession of the thing or property in question, whether by the person entitled to such right or by some other person for his benefit.

371(7) In this section, “property” includes any description of real and personal property, money, debts, bank credits, and legacies and all deeds and instruments relating to or evidencing the title or right to any property or giving a right to recover or receive any money or goods and also includes not only such property as has been originally in the possession or in the control of any person but also any property in which or for which it has been converted or exchanged and anything acquired by the conversion or exchange, whether immediately or otherwise.”

— *Case example* —

The former Deputy Premier of Western Australia (D) was charged with theft for several withdrawals totalling about \$58,000 from an account with the Commonwealth Bank opened in the name of the “ALP David Parker for Fremantle Campaign” into which campaign donations were paid. The withdrawals were for private purposes unconnected with the Fremantle campaign. D and two of his staff members were signatories on the account. Because the identity of the owner of the donated money was not clear, the prosecution relied on the provisions of sec 373 which deemed ownership to remain with the giver,¹⁸ and the offence to have taken place when the money was taken by the accused. The charges based on this section were dismissed on the basis that the money could not be deemed to be trust money: the donations had been given to the accused. The prosecution was not permitted to amend the charges to prosecute under sec 371.

_____ *Parker v The Queen*¹⁹ _____

¶2-340 **Theft in Victoria, ACT, NT.** In comparison to the technicalities associated with the common law definition of larceny (¶2-330), the *Theft Act 1968* (UK) is expressed in simple language. It provides the basis for the theft laws of Victoria (1973), the Northern Territory (1983)²⁰ and the Australian Capital Territory (1985). As the model of modern theft law, sec 72-73 of the *Crimes Act 1958* (Vic) (with parallels in sec 209-210 (NT) and sec 94-97 (ACT)) states:

“Basic definition of theft.

72(1) A person steals if he dishonestly appropriates property belonging to another with the intention of permanently depriving the other of it.

72(2) A person who steals is guilty of theft; and ‘thief’ shall be construed accordingly.

Further explanation of theft.

73(1) This section has effect as regards the interpretation and operation of section 72 and, except as otherwise provided in this Division, shall apply only for the purposes of that section and not otherwise.

18. Compare *Crimes Act 1958* (Vic) sec 73(9):
¶2-340.

20. Northern Territory Code Pt VII
(Property Offences and Related Matters).

19. (1997) 186 CLR 494.

73(2) [**Dishonest**] A person's appropriation of property belonging to another is not to be regarded as dishonest—

- (a) if he appropriates the property in the belief that he has in law the right to deprive the other of it, on behalf of himself or of a third person; or
- (b) if he appropriates the property in the belief that he would have the other's consent if the other knew of the appropriation and the circumstances of it; or
- (c) (except where the property came to him as trustee or personal representative) if he appropriates the property in the belief that the person to whom the property belongs cannot be discovered by taking reasonable steps.

73(3) A person's appropriation of property belonging to another may be dishonest notwithstanding that he is willing to pay for the property.

73(4) [**Appropriates**] Any assumption by a person of the rights of an owner amounts to an appropriation, and this includes, where he has come by the property (innocently or not) without stealing it, any later assumption of a right to it by keeping or dealing with it as owner.

73(5) Where property or a right or interest in property is or purports to be transferred for value to a person acting in good faith, no later assumption by him of rights which he believed himself to be acquiring shall, by reason of any defect in the transferor's title, amount to theft of the property.

73(6) [**Property**] A person cannot steal land, or things forming part of land and severed from it by him or by his directions, except in the following cases, that is to say—

- (a) when he is a trustee or personal representative, or is authorized by power of attorney, or as liquidator of a company, or otherwise, to sell or dispose of land belonging to another, and he appropriates the land or anything forming part of it by dealing with it in breach of the confidence reposed in him; or
- (b) when he is not in possession of the land and appropriates anything forming part of the land by severing it or causing it to be severed, or after it has been severed; or
- (c) when, being in possession of the land under a tenancy, he appropriates the whole or part of any fixture or structure let to be used with the land.

For purposes of this sub-section 'land' does not include incorporeal hereditaments; 'tenancy' means a tenancy for years or any less period and includes an agreement for such a tenancy, but a person who after the end of a tenancy remains in possession as statutory tenant or otherwise is to be treated as having possession under the tenancy, and 'let' shall be construed accordingly.

73(7) Wild creatures, tamed or untamed, shall be regarded as property; but a person cannot steal a wild creature not tamed nor ordinarily kept in captivity, or the carcase of any such creature, unless either it has been reduced into possession by or on behalf of another person and possession of it has not since been lost or abandoned, or another person is in course of reducing it into possession.

73(8) **[Belonging to another]** Where property is subject to a trust, the persons to whom it belongs shall be regarded as including any person having a right to enforce the trust, and an intention to defeat the trust shall be regarded accordingly as an intention to deprive of the property any person having that right.

73(9) Where a person receives property from or on account of another, and is under an obligation to the other to retain and deal with that property or its proceeds in a particular way, the property or proceeds shall be regarded (as against him) as belonging to the other.

73(10) Where a person gets property by another's mistake, and is under an obligation to make restoration (in whole or in part) of the property or its proceeds or of the value thereof, then to the extent of that obligation the property or proceeds shall be regarded (as against him) as belonging to the person entitled to restoration, and an intention not to make restoration shall be regarded accordingly as an intention to deprive that person of the property or proceeds.

73(11) Property of a corporation sole shall be regarded as belonging to the corporation notwithstanding a vacancy in the corporation.

73(12) **[Intention of permanently depriving]** A person appropriating property belonging to another without meaning the other permanently to lose the thing itself is nevertheless to be regarded as having the intention of permanently depriving the other of it if his intention is to treat the thing as his own to dispose of regardless of the other's rights; and a borrowing or lending of it may amount to so treating it if, but only if, the borrowing or lending is for a period and in circumstances making it equivalent to an outright taking or disposal.

73(13) Without prejudice to the generality of sub-section (12) where a person, having possession or control (lawfully or not) of property belonging to another, parts with the property under a condition as to its return which he may not be able to perform, this (if done for purposes of his own and without the other's authority) amounts to treating the property as his own to dispose of regardless of the other's rights.

73(14) **[Motor vehicles and aircraft]** Notwithstanding anything contained in sub-section (12) in any proceedings—

- (a) for stealing a motor vehicle or an aircraft proof that the person charged took or in any manner used the motor vehicle or aircraft without the consent of the owner or person in lawful possession thereof shall be conclusive evidence that the person charged intended to permanently deprive the owner of it; and
- (b) for attempting to steal a motor vehicle or an aircraft proof that the person charged attempted to take or in any manner use the motor vehicle or aircraft without the consent of the owner or person in lawful possession thereof shall be conclusive evidence that the person charged intended to permanently deprive the owner of it.”

“Property” that can be stolen is defined to include “money and all property real or personal including things in action and other intangible property.”²¹

— *Case example* —

Stolen phone calls. D made a number of unauthorised long distance phone calls. The court held that a phone call is not “property” for the purposes of theft, as property must exist before it can be stolen. The act of making a phone call did not deprive the phone subscriber of anything, as all that it did was to create an obligation on the part of the subscriber to pay for the calls.

_____ *Akbulut v Grimshaw*²²—

Current case law suggests that “property” would not include theft of property held in electronic format, such as a money transfer by deception, electronic payment of debit entries into a thief’s bank account or theft of shares held in electronic format,²³ and that the prosecution may instead prosecute under the broader offence of “obtaining financial advantage by deception” which is not based on “property”.²⁴

¶2-350 Further white-collar offences. In addition to specific law on larceny or theft, Commonwealth, State and Territory criminal law abounds with sanctions covering a wide range of what might be called white-collar or business crime.

All jurisdictions have supplemented their general provisions on larceny or theft with further indictable or summary offences, all of which bear some significance in the area of business (¶2-360—¶2-400).

¶2-360 Embezzlement. The crime of embezzlement was created by statute in 1799²⁵ in response to the decision in the following case which held that a “servant” (employee) had had possession of property of his “master” (employer) and therefore could not be convicted of larceny because there was no taking from the possession of another without consent. There was no taking of possession from the “master”, and any taking from the third party was consensual. In other words, where the “servant” received possession from a third party on behalf of the “master” (such as a shop assistant taking money), the “servant” had possession until passing the property into the possession of the master (eg putting the money into the till).

21. *Crimes Act 1958* (Vic) sec 71 (“property”); compare *Crimes Act 1900* (NSW) sec 93, applying in the ACT; Northern Territory Code sec 1 (“property”). This definition overcomes the difficulties of the common law of larceny (¶2-330) by providing that instruments creating or evidencing choses in action (¶3-040) with no intrinsic value can be the subject of theft. Therefore under the legislation, a cheque can be

stolen: *Parsons v The Queen* (1999) 73 ALJR 270: ¶16-200.

22. [1998] 3 VR 756; (1998) 96 A Crim R 599, noted (1998) 72 ALJ 770.

23. Lipton, J, *Property offences in the electronic age* (1998) 72(10) LIJ 54.

24. eg *Crimes Act 1958* (Vic) sec 82; *Crimes Act 1900* (NSW) sec 104, which applies in the ACT.

25. 39 Geo 3, c 85.

— Case example —

Before introduction of embezzlement law

A customer paid a bank cashier £137 for deposit. The amount included a £100 note. The cashier put the £37 in the correct drawer, but immediately appropriated the £100 note. It was held that he could not be convicted of larceny of the £100 note because he had not taken from the customer, nor had he taken from the possession of the bank because the cashier was expressly given possession (ie the money was never in the possession of the bank).

— *R v Bazeley*²⁶ —

Statutory regulation of embezzlement by a clerk or servant in Australia is based on the Imperial legislation passed in response to the decision in *Bazeley*. The Australian statutes provide that the crime of embezzlement is committed where a “clerk or servant” steals any property belonging to or in the possession of the master or employer, or any property taken into possession on behalf of the master or employer.²⁷

¶2-370 Fraudulent conversion. The statutory offence of fraudulent conversion or fraudulent misappropriation is a general provision covering various kinds of fraudulent misappropriation of money, valuable security or property collected or received. In the words of the South Australian Act:²⁸

“184(1) Any person who—

- (a) being entrusted, whether the instructions are written, verbal, or implied, either solely or jointly with any other person, with any property in order that he may retain in safe custody, or apply, pay or deliver for any purpose or to any person, the property or any part thereof or any proceeds thereof; or
- (b) having, either solely or jointly with any other person, received any property for, or on account of, any other person,

fraudulently converts to his own use or benefit, or the use or benefit of any other person, the property or any part thereof or any proceeds thereof, or fraudulently destroys the property or any part thereof or any proceeds of the property or part thereof, shall be guilty of a misdemeanour and liable to be imprisoned for a term not exceeding seven years.

184(2) Nothing in this section shall apply to or affect any trustee of any express trust created by a deed or will, or any mortgagee of any property, real or personal, in respect of any act done by the trustee or mortgagee in relation to the property comprised in, or affected by, any such trust or mortgage.”

26. (1799) 2 Leach 835; 168 ER 517.

27. eg *Crimes Act 1900* (NSW) sec 157; *Crimes Act 1958* (Vic) sec 72; *Criminal Law Consolidation Act 1935* (SA) sec 176(1); *Criminal Code* (Qld) sec

158(a)(ii); *Criminal Code* (WA) sec 371; *Criminal Code* (Tas) sec 226.

28. eg *Criminal Law Consolidation Act 1935* (SA) sec 184; *Crimes Act 1900* (NSW) sec 178A.

The offence overlaps and is wider than larceny as a bailee, larceny by a clerk or servant and embezzlement. As well, it can be distinguished from fraudulent appropriation²⁹ and obtaining property by false pretences.³⁰

¶12-380 False accounting. Some of the Acts contain sections dealing with falsification of documents or records and accounting offences but there have been very few cases under the sections. For example, the Victorian section reads as follows:³¹

“83(1) Where a person dishonestly, with a view to gain for himself or another or with intent to cause loss to another—

- (a) destroys, defaces, conceals or falsifies any account or any record or document made or required for any accounting purpose; or
- (b) in furnishing information for any purpose produces or makes use of any account, or any such record or document as aforesaid, which to his knowledge is or may be misleading, false or deceptive in a material particular—

he is guilty of an indictable offence and liable to ... imprisonment.

83(2) For purposes of this section a person who makes or concurs in making in an account or other document an entry which is or may be misleading, false or deceptive in a material particular, or who omits or concurs in omitting a material particular from an account or other document, is to be treated as falsifying the account or document.”

¶12-390 Frauds by factors and other agents. Misappropriation by an agent of money, property or goods is made an offence. Read with the civil consequences of an agent's breach of duty to the principal (¶11-140), these sections carry extra weight in reflecting the law's views on the strictness of an agent's duties and responsibilities to the principal:³²

“164. For the purposes of sections 165 to 171 both inclusive:

‘intrusted’ means intrusted, either solely, or jointly, with any other person;

‘agent’ includes bankers, merchants, attorneys, factors, brokers, and every other person acting in the capacity of an agent so intrusted;

‘misappropriate’ means appropriate in any manner whether by sale, pledge, or otherwise, to the agent's own use or benefit, or the use or benefit of some one other than the person, by, or for whom, he was so intrusted.”

29. eg *Crimes Act 1900* (NSW) sec 124, 527.

30. eg *Crimes Act 1900* (NSW) sec 179; *Criminal Law Consolidation Act 1935* (SA) sec 195.

31. eg *Crimes Act 1958* (Vic) sec 83; *Crimes Act 1900* (NSW) sec 158, 175; *Criminal*

Law Consolidation Act 1935 (SA) sec 178; *Criminal Code* (WA) sec 424; *Criminal Code* (Tas) sec 264, 265.

32. eg *Crimes Act 1900* (NSW) sec 164, 165, 166, 168, 170, 171; *Criminal Law Consolidation Act 1935* (SA) sec 186; *Criminal Code* (WA) sec 378(9).

¶2-400 Frauds by other persons in business. All the criminal law legislation contains sections covering misappropriation by various other persons including:

- clerks or servants (falling short of embezzlement (¶2-360) because the property is already in the employer's possession);
- tenants or lodgers;
- company officers;
- trustees;
- public servants;
- partners and joint owners;
- persons acting under power of attorney (¶11-030).

These sections are rarely invoked, first because of the difficulty in detecting white-collar crime, and secondly because a civil action may yield fair compensation whereas the end result of invoking the criminal process will be a public penalty.

Chapter 3

Property

CONCEPT OF PROPERTY	¶3-010—¶3-060
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CONCEPT OF PROPERTY _____

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¶3-010 Meaning of property. Property refers to something able to be owned and to the rights involved in that ownership. Property can be classified as:

¶3-010

- real property (or realty) — land, fixtures (things affixed to land such as buildings: ¶3-080—¶3-110) and leaseholds (¶3-740—¶3-770);
- personal property (or personalty) — all property other than real property; and
- intellectual property — copyright, designs, patents and trade marks (¶3-470—¶3-695).

¶3-020 Real and personal property. Although everyday business terms, the terms “real” and “personal” property have an ancient pedigree. They are derived from the kind of court action used by a person in the Middle Ages wrongfully dispossessed of real or personal property:

- a landowner (a “freeholder”) dispossessed of land took action to recover the land (or the “thing”) itself. The Latin for the noun “thing” is *res* and the action taken was an action *in rem*, later known as a *real* action.
- a person dispossessed of goods and chattels might not be able to recover the property itself because it might have been destroyed. Action would be taken for damages against the wrongdoer personally without a claim necessarily being made for recovery of the property itself. Hence the legal action taken was an action *in personam*, or a *personal* action.

Property recoverable by a real action gradually came to be called *real* property and other property came to be called *personal* property. Real and personal property takes many sizes, shapes and forms.

Articles of personal property — chattels — can be divided into two main classes:

- chattels personal (which are moveable, tangible articles of property);
- chattels real (which are interests in land less than freehold, such as leaseholds).

¶3-040 Choses. There may be rights of property over non-physical and non-tangible property, such as shares and benefits under a contract, and accordingly the law provides another classification of personal property:

- choses in possession (which are tangible physical property);
- choses in action (covering rights enforceable by legal action over real property (eg under a contract for sale of land) and personal property (eg right to a tangible thing or intangible property under a contract for sale, etc)).

Chose is a French word (meaning a thing) which was introduced as part of the legal language following the conquest of Britain by the Norman French in 1066.¹ Choses take one of two forms, namely choses in possession (tangible, physical property) and choses in action (intangible rights over property):

1. French remained the language of the law (the courts, legal documents, etc) for the

next few centuries in a corrupted form called law-French.

(1) *Choses in possession: physical property.* Choses in possession is a legal expression meaning tangible, moveable and visible things or goods, such as cars, furniture, mobile phones, money and the other chattels of everyday life. By definition, a chose in possession is always in someone's possession. Transfer of ownership of tangible property is discussed at ¶13-460.

(2) *Choses in action: intangible property.* Choses in action are rights which cannot be claimed or enforced by taking physical possession but are instead enforceable by legal action in the courts. "Chose in action" describes both the right enforceable by legal action and the right of action itself. For example, the right to sue for an amount of money is a chose in action — it is a proprietary right. A chose in action can be used as security for a loan: ¶13-330. Transfer of ownership of intangible property is discussed at ¶13-460.

(a) *Legal choses in action.* The range of rights of action enforceable by action in the common law courts is wide and includes the following classes of property:

- Contracts, agreements, arrangements; annuities; shares in a company, securities and other debts.
- Negotiable instruments such as bills of exchange (see Chapter 16).²
- Patents and designs. A patent is a right granted to a person by the Crown to the exclusive use and benefit of a new invention (¶13-580—¶13-640). Designs can also be registered (¶13-550—¶13-570).
- Copyright and trade marks. Copyright is the exclusive proprietary right in a public literary work such as a book, music, film, etc (¶13-480—¶13-545). Trade marks are discussed at ¶13-650—¶13-680.
- Business and trade names. These can be registered under various statutes (business names, associations incorporation, and the Corporations Law) and can be protected under (amongst other things) the tort of passing off. See ¶12-010—¶12-050.

(b) *Equitable choses in action.* In addition to the legal choses in action, there are the following equitable choses in action (ie enforceable only in courts of equity):

- a partner's interest in a partnership (¶10-390; ¶10-480);³
- a right to a legacy (¶13-240);
- an interest in a trust estate (¶9-760).

The main difference between a chose in possession and a chose in action lies in the physical possession — and the use and enjoyment — which characterises a chose in possession, in contrast to the legal protection of an interest which characterises a chose in action.

2. A cheque and a bank cheque are more than a chose in action held by the payee against the drawer, due to the effect of the *Cheques Act 1986* (Cth) sec 25, 71,

76 and 116: *Parsons v The Queen* (1999) 73 ALJR 270 at p 277; ¶16-200.

3. eg *FC of T v Everett* (1980) 143 CLR 440 at p 447 (High Court); ¶10-480.

The assignment of a chose in action is discussed at ¶13-340.

¶13-050 Ownership v possession of property. A person may own property without possessing it, and a person may be in possession of property without owning it.

— *Example* —

A landlord owns a house which a tenant possesses. The house may be subject to a mortgage (¶13-040), which means that if the landlord (mortgagor) defaults on repayments, the lender (mortgagee) may sell it to be repaid. In addition, various authorities such as local government, gas and water have access, for various purposes, to the landlord's property in the possession of the tenant.

The owner is the person entitled to all the legal rights over the property, and can transfer the property to another person (¶13-155). The owner has "title" to the property, and can prove title by showing a chain of title back to an "unchallengeable beginning" such as the Crown (for real estate) or the retailer or manufacturer (for personal property).

Possession involves the physical control by the possessor over property (¶13-060).

Possession in law has two elements:

- (1) physical control over the property possessed, either directly or through others (employees, agents);
- (2) the intention to assert exclusive control of the property possessed. A person holding property on behalf of another person (for example, for safe keeping) may not in law be the person in possession if there is no intention to exert exclusive control.

Under security transactions such as a mortgage (¶13-040—¶13-047), hire-purchase (¶13-050), a bill of sale (¶13-070—¶13-140), a charge (¶13-048), a pledge (¶13-190—¶13-210), or a lien (¶13-230—¶13-290), possession or a right to possession upon default by the owner is passed by the legal owner (the borrower) to the security holder (the lender).

¶13-060 Rights of the person in possession. The rights of a person in possession — who may not be the legal owner — are protected by the law. It is indeed true to claim that "possession is nine-tenths of the law" because possession is good against the whole world except the true owner. In the case of security transactions (noted in ¶13-050) and in other legal situations such as bailment (Chapter 15), the protection given to the person in possession may well take precedence over the rights of the actual owner of the property in question.

Because possession is good against the whole world except the true owner, the law will protect the possession of a finder against all but the true owner.

— *Case example* —

Finding a jewel. P, a chimney sweeper's "boy" found a jewel at work and took it to a goldsmith for assessment. The goldsmith refused to return it, and P successfully sued in the tort of conversion. The court stated that "the finder of a jewel, though he does not by such finding acquire an absolute property or ownership, yet he has such a property as will enable him to keep it against all but the rightful owner ...". In other words, a person (who was not the true owner of the jewel) who interfered with the possession of the finder could not deny that the finder was the owner. In this case, there was no claim by the landowner where the jewel was found.

*Armory v Delamirie*⁴ —

There have been many cases concerning the rights of a finder versus other claimants to the property which confirm that the principle "finders keepers" is compatible with the principle that an owner or possessor of land owns all that is in or attached to the land:

— *Case examples* —

A person entering a shop found on the floor of the "public part" of the shop a parcel containing a bundle of bank notes which had been accidentally dropped there by a stranger. The shopkeeper did not know that the notes were there until notified by the finder. The court held the finder had a better claim to the banknotes than the defendant shopkeeper: "The notes never were in the custody of the defendant, nor within the protection of his house, before they were found, as they would have been had they been intentionally deposited there." But the court did not say that an object dropped by a guest in a private house would not be in the custody of the householder. Such an object would be within the protection of the house and would be in the householder's possession subject to the rights of the true owner.

*Bridges v Hawkesworth*⁵ —

The case of the prehistoric boat. While excavating to build a gasholder, the lessee gas company discovered embedded in the clay, about two metres below the surface, and within a few metres of a river, an ancient prehistoric ship or boat about 15 metres long, and apparently hollowed out of a large oak tree. The court held in favour of the lessor, despite the lease to the gas company, because the lessor was in possession of the land even though the lessor did not know of the existence of the boat. After so many centuries, the right of the original owner could not be established.

*Elwes v Brigg Gas Company*⁶ —

The medieval gold brooch. D found a valuable medieval gold brooch with his metal detector about 22 cm below the surface in a public park. Applying the principle that the owner or lawful possessor of land owns all that is in or attached to the land, the court upheld the claim of the owner of the park,

4. (1722) 1 Strange 505; 93 ER 664; compare *Ranger v Giffin* (1967) 87 WN (Pt 1) (NSW) 531 (bank notes in tin held to belong to owner of the property, not finder).

5. (1851) 21 LJ(NS)QB 75 at p 78; applied in *Parker v British Airways Board* [1982] 1 QB 1004; [1982] 1 All ER 834.

6. (1886) 33 Ch D 562.

the local council. If the brooch had been found, for example, in a bush *on* the land, ownership would pass to the finder if there was no evidence that the owner intended to control the land and anything that might be found on it.

*Waverley Borough Council v Fletcher*⁷ —

The bag of money. Mrs P was the sole tenant of a house which her son, who had a key, visited about twice a week. The National Crime Authority was investigating her son, and obtained a search warrant to search P's house. The NCA found and confiscated a briefcase containing about \$430,000 in bank notes, which Mrs P stated she knew nothing about. No further action was taken by the NCA. Mrs P succeeded in her claim for the return of the money on the basis that she had the strongest claim to it under "possessory title", which the court confirmed to be as good as absolute title of ownership as against all the world except the true owner.

*Chairperson, National Crime Authority v Flack*⁸ —

The Mugga Lane Landfill area tip. Members of the public could dump rubbish at a tip run by the ACT government, which, if not salvaged, was eventually bulldozed and covered with soil. Under a licence agreement, the government gave exclusive scavenging rights at the tip to a licensee company. The court confirmed that the government:

- did not acquire ownership of the goods merely because they were dumped and therefore it did not have a better title than the person who dumped them.
- had a better title to the abandoned goods than any person except the owner. Property remained with the owner until the goods were appropriated (ie until buried).
- had taken control of the goods left at the tip. This control was effective against all others except the owner, and the government was entitled to license the company so that it could control salvage at the tip.

*Munday v Australian Capital Territory*⁹ —

7. [1995] 4 All ER 756.

8. (1998) 156 ALR 501, noted (1998) 72 ALJ 857.

9. (1998) 99 LGERA 312, noted (1999) 73 ALJ 175. "Waste" is anything which is

discarded, and therefore excludes materials to be reused in recycling rather than to be disposed of: *Mayer-Parry Recycling Ltd v The Environment Agency* [1998] TLR 763, noted (1999) 73 ALJ 334.

DEFINITION OF LAND

Limits of land	¶3-070
Limits of land: (1) fixtures	¶3-080
Articles held to be fixtures	¶3-090
Articles held not to be fixtures	¶3-100
Tenant's fixtures	¶3-110
Limits of land: (2) upwards	¶3-120
Limits of land: (3) downwards	¶3-150

¶3-070 Limits of land. The expression “land” normally suggests houses, farms, bush and other aspects of the earth’s surface. In law, however, “land” has a more expanded meaning.

- (1) Land includes fixtures, namely those goods and chattels which are attached to the land (¶3-080—¶3-110).
- (2) Land according to its strict legal meaning — and subject to various case law decisions and statutory provisions — extends upwards to the heavens (¶3-120) and downwards indefinitely to the centre of the earth (¶3-150). It includes the technical term “curtilage”, meaning the appendage (land, garden or yard) of a primary building or outbuildings.¹⁰

¶3-080 Limits of land: (1) fixtures. Numerous principles have been laid down by the courts to determine whether items have been attached or affixed to the land, as set out in the following classic statement:¹¹

“A fixture is a thing once a chattel which has become in law land through having been fixed to land. The question whether a chattel has become a fixture depends upon whether it has been fixed to land, and if so for what purpose. If a chattel is actually fixed to land to any extent, by any means other than its own weight, then *prima facie* it is a fixture; and the burden of proof is upon anyone who asserts that it is not: if it is not otherwise fixed but is kept in position by its own weight, then *prima facie* it is not a fixture; and the burden of proof is on anyone who asserts that it is ... The test of whether a chattel which has been to some extent fixed to land is a fixture is whether it has been fixed with the intention that it shall remain in position permanently or for an indefinite or substantial period ... or whether it has been fixed with the intent that it shall remain in position only for some temporary purpose ... In the former case, it is a fixture, whether it has been fixed for the better enjoyment of the land or building, or fixed merely to steady the thing itself, for the better use or enjoyment of the thing fixed ... If it is proved to have been fixed merely for a temporary purpose it is not a fixture ... The intention of the person fixing it must be gathered from the purpose for which and the time during which use in the fixed position is

10. Obsolete?: *The meaning of the term “curtilage”* (1988) 62 ALJ 585.

11. *Australian Provincial Assurance Co Ltd v Coroneo* (1938) 38 SR (NSW) 700, per Jordan CJ at pp 712-713.

contemplated ... If a thing has been securely fixed, and in particular if it has been so fixed that it cannot be detached without substantial injury to the thing itself or to that to which it is attached, this supplies strong but not necessarily conclusive evidence that a permanent fixing was intended ... On the other hand, the fact that the fixing is very slight helps to support an inference that it was not intended to be permanent. But each case depends on its own facts.”

Even if status as a fixture is not in doubt, the intention of the parties to the contract may determine whether or not ownership of a fixture is to pass with title to the land.

In some circumstances, fixtures may be repossessed by a lender: ¶13-160.

Examples of cases where articles were or were not held to be fixtures are given in ¶13-090—¶13-100 below.

¶13-090 Articles held to be fixtures. Application of the principles set out in ¶13-080 has resulted in the following goods and chattels being held to be fixtures and therefore part of the land in question:

- A timber house in North Queensland, resting on land by its own weight but brought there for the purpose of being permanently used as a house.¹²
- Similarly, wooden bungalows, resting on concrete pillars in the ground, which could not be taken down and re-erected elsewhere without demolition.¹³ A house which is removable as a unit or in sections may remain a chattel even if connected temporarily to services such as water and electricity.
- A PABX telephone system.¹⁴
- Two air conditioning units installed in a well in the roof of a convention centre fastened by bolts into a fitting in the concrete floor of the well. The units were connected to a switchboard by electric cables and were attached to steel ducting.¹⁵
- Plant and equipment in a furniture factory. Some of the items were bolted to the concrete floor, some were wired into the electrical system and some were piped into the factory dust extraction system.¹⁶
- A free-standing gas stove connected to the gas supply on a flexible hose. The provision of cooking facilities was held to form an essential and integral element of a kitchen and, despite its very slight degree of

12. *Reid v Smith* (1905) 3 CLR 656.

13. *Elitestone Ltd v Morris* [1997] 1 WLR 687, noted (1997) 71 ALJ 820.

14. eg *NH Dunn Pty Ltd v LM Ericsson Pty Ltd* (1979) 2 BPR 9241.

15. *Pan Australian Credits (SA) Pty Ltd v Kolim Pty Ltd* (1981) 27 SASR 353.

16. *In the matter of Starline Furniture Pty Ltd (in liq)* (1982) 1 ACLC 221.

annexation, the stove was characterised as for the benefit of the premises.¹⁷

¶3-100 Articles held not to be fixtures. Application of the principles set out at ¶3-080, and in particular the determination of the parties' intention to affix, has resulted in the following articles being held to be chattels, not fixtures:

- A temporary office built in a warehouse by the licensee, in use for ten weeks, fixed to the floor with masonry nails and bolted to the side of the warehouse building.¹⁸
- A dishwasher, TV aerial and washing machine.¹⁹

¶3-110 Tenant's fixtures. Tenant's fixtures are goods annexed by the tenant to the leased premises which are removable by the tenant (¶3-760). The test for determining whether the goods become fixtures is the intention with which they were placed on the land, not the degree of attachment.

The law concerning tenant's fixtures must be interpreted in the light of the actual lease between landlord and tenant, but in general tenant's fixtures include:

- (1) articles erected for ornamental or domestic convenience, which can be removed without substantial damage to the leased property; and
- (2) trade fixtures, erected for the purpose of carrying on some trade, business or manufacture.

At common law a tenant has the right to remove tenant's fixtures from the leased property so long as the tenant has remained in possession.²⁰

¶3-120 Limits of land: (2) upwards. In theory, and based on the Latin maxim *cuius est solum eius est usque ad coelum et ad inferos* (where one owns the ground, one's ownership extends up to the heavens and down to the infernal regions), ownership of land is unlimited upwards and downwards.²¹ Whether ownership of land is or is not unlimited in height, for practical purposes limitations are imposed by current technology upon an owner's ability to use and occupy the land.

17. *Palumberi v Palumberi* (1986) NSW ConvR ¶55-287, noted (1986) 60 ALJ 582. Carpets also upheld as fixtures; but venetian blinds, built-in linen cabinet and television antenna not fixtures. See generally Butt, P, *Selling land separately from fixtures* (2000) 74 ALJ 130.

18. *Ball-Guymer v Livantes* (1990) 102 FLR 327.

19. Cocks, R, *Property Law Q&A* (1991) 65 LJ 143.

20. See further Aitken, L, *Applications in equity: removal of tenant's fixtures?* (1999) 73 ALJ 834.

21. This "colourful phrase often on the lips of lawyers since it was first coined by Accursius in Bologna in the 13th century": *Bernstein of Leigh (Baron) v Skyviews & General Ltd* [1978] QB 479 at p 485. It is analysed by Butt, P, *The limits of application of the maxim "cuius est solum eius est usque ad coelum"* (1978) 52 ALJ 160. It seems that transferable floor space rights or "air space rights" are not "land": Butt, P (1991) 65 ALJ 474.

(1) *Overhanging branches.* An owner of land has clear rights to the air space above the land and has the right to lop the branches of trees that may overhang the boundary.²²

(2) *Overhanging wires.* An owner of land is entitled under the tort of trespass to remove a wire placed at any height above the land.²³ The common law principle must, however, be read in the light of statutory rights given to telephone, electrical and other statutory authorities to erect telegraph lines and other installations.

(3) *Overhanging buildings, pipes, signs.* An owner of land is entitled to protect its air space against incursions by overhanging buildings, pipes or signs. Action can be taken under the tort of trespass and an injunction can be sought to order their removal. Injunctions have been granted in situations involving:

- a sign projecting 142 cm over the plaintiff's forecourt;²⁴
- an advertising sign about 6 metres long and 3 metres high which projected about 20 cm over the plaintiff's property.²⁵

Court orders such as an order for removal can also be made under encroachment of buildings legislation.

(4) *Transient incursions into air space.* The principle that ownership of land extends up to the heavens is not always easy to apply in the case of temporary and transient incursions into the land owner's air space. Cases take the view that an owner is entitled to an injunction to restrain trespass whether or not harmed by the trespass and that an owner should be free to charge for otherwise unused air space. A court should not force an owner to license a trespasser:

- In 1815 it was said that firing a gun across a field was trespass only if the shot struck the land. If it did not strike the land, there was no trespass although the conduct might be actionable as nuisance.²⁶
- Shooting a cat on the roof of a shed in the adjoining yard was held to constitute entry into the air space and therefore trespass.²⁷
- Trespass to air space by overhanging cranes, scaffolding and other building operations is well recognised in law. A mandatory injunction was granted during construction of a multi-storey building to restrain trespass caused by the crane jib and by wire mesh screens which covered the outside of the building to prevent persons or objects from falling.²⁸

22. *Lemmon v Webb* [1894] 3 Ch 1.

23. *Wandsworth Board of Works v United Telephone Co Ltd* (1884) 13 QBD 904.

24. *Gifford v Dent* (1926) 43 WN (NSW) 336.

25. *Kelsen v Imperial Tobacco Co (of Great Britain and Ireland) Ltd* [1957] 2 QB 334; [1957] 2 All ER 343.

26. *Pickering v Rudd* (1815) 4 Camp 219; 171 ER 70.

27. *Davies v Bennison* (1927) 22 Tas LR 52.

28. *Bendal Pty Ltd v Mirvac Project Pty Ltd* (1991) 23 NSWLR 464, noted (1992) 66 ALJ 40.

— *Case example* —

When an aerial photography company took a single and unauthorised aerial photograph of his Kent residence, Lord Bernstein sued for trespass and/or breach of privacy. The company's business for 17 years had been to take aerial photographs of properties of all types and to offer them for sale to the owners. On the evidence of the managing director of the company, this case marked the first complaint. The court refused to award damages, and it limited the *cuius* maxim to the height necessary for the ordinary use and enjoyment of land:

"I can find no support in authority for the view that a landowner's rights in the air space above his property extend to an unlimited height. In *Wandsworth Board of Works v United Telephone Co Ltd* 13 QBD 904 Bowen LJ described the maxim, *usque ad coelum*, as a fanciful phrase, to which I would add that if applied literally it is a fanciful notion leading to the absurdity of a trespass at common law being committed by a satellite every time it passes over a suburban garden. ... The problem is to balance the rights of an owner to enjoy the use of his land against the rights of the general public to take advantage of all that science now offers in the use of air space. This balance is in my judgment best struck in our present society by restricting the rights of an owner in the air space above his land to such height as is necessary for the ordinary use and enjoyment of his land and the structures upon it, and declaring that above that height he has no greater rights in the air space than any other member of the public. Applying this test to the facts of this case, I find that the defendants' aircraft did not infringe any rights in the plaintiff's air space, and thus no trespass was committed."

————— *Bernstein of Leigh (Baron) v Skyviews & General Ltd*²⁹ —

This case did not decide that unauthorised overflying is not trespass, and the judge made it clear that it was only the particular facts in the case which did not fall within trespass, nuisance, or damage by aircraft legislation.

The upwards limit of land may increasingly become an issue with the wish of the solar energy user to protect access to sunlight, and with the risks of space-object outfall from satellites and other space activities as well as from military activities.

¶3-150 Limits of land: (3) downwards. The extended version of the *cuius* maxim (¶3-120) ends with the words "*et ad inferos*", confirming that at common law ownership of land is unlimited upwards and downwards³⁰ to the centre of the earth.

— *Case example* —

The case of the cellar. A butcher owned adjoining semi-detached properties in Church Hill, Sussex. He lived in Property P, which was purely residential,

29. [1978] QB 479 at pp 487-488.

30. *Duke of Devonshire v Pattinson* (1887) 20 QBD 263 at p 273: "it is a presumption

that a demise of land described by superficial metes and bounds carries with it the land to the centre of the earth".

and used Property D next door, which was partly residential, for his business. The properties had separate entrances, but were interconnected by doors on the ground floor and an upper floor. There was a cellar beneath the sitting room of Property P, with access only by steps from Property D, which the butcher used for part of his business. Following the death of the butcher, the properties were sold to H, who decided to sell them separately. He bricked up the interconnecting doors except the door in Property D opening to the stairs to the cellar under Property P and sold Property P to the plaintiff's predecessor. This conveyance was expressed to be of "ALL THAT dwelling house and premises situate on the west side of Church Hill ... as the same is for the purpose of identification only more particularly delineated on the plan annexed hereto and thereon edged with pink ...". H later transferred Property D to the defendant, who then began to use the cellar underneath the sitting room of Property P.

The plaintiff sought an injunction to restrain the defendant from entering the cellar and the defendant claimed that the cellar was not part of the "dwelling house" of P but instead was part of Property D.

In finding for the plaintiff, the court held that, in the absence of anything to the contrary, a conveyance of property included not only everything on the surface but the whole substratum to the centre of the earth, and accordingly the cellar belonged to Property P.

— *Grigsby v Melville*³¹ —

The *cuius* maxim has been limited by mining legislation (which vests minerals like gold, silver and petroleum in the Crown) and groundwater legislation (which gives control and use to the Crown). In addition, legislation and certain proclamations place limitations on the principle that a conveyance or transfer of land includes the surface of the land and land directly beneath the surface.

OWNERSHIP OF LAND

Ownership of land	¶3-155
Joint tenancy and tenancy in common	¶3-160
Joint tenancy: the four unities	¶3-180
Tenancy in common	¶3-190
Multi-ownership of land	¶3-195

¶3-155 Ownership of land. People with ownership, legal interest or an estate in land have the right to the exclusive use of the land. Their ownership rights are "proprietary" because they are enforceable against the whole world and are enforceable *in rem* (¶3-020).³² Their rights include the right to sell or dispose of the land. They may be entitled to compensation in certain circumstances such as compulsory acquisition. They have the right to lodge a caveat to protect their right to the land (¶3-280).

31. [1973] 3 All ER 455.

32. In contrast with proprietary rights, contractual rights are only enforceable

against the parties to the contract. They are enforceable *in personam*: ¶3-020.

Examples of ownership, legal interest or an estate in land include:

- (1) fee simple or a freehold interest. This is an unlimited estate in land. It continues for an uncertain duration until the current owner dies without an heir, when the land reverts to the Crown. It gives the owner the right to sell or to lease the land.
- (2) life estate. This is a freehold interest limited to the duration of the life of the holder or during the life of another person. For example, a husband may transfer land under his will to his wife for her life. The wife as a life tenant cannot sell the land, and must take reasonable care of it for the next owner (the “remainderman”).
- (3) future interests: expectant estate or an estate on expectancy. This refers to the right to the land at some future time.

— *Future interests: example* —

Remainder. In the life estate example above, the husband’s land may revert to his children in equal shares when his wife dies and her life estate ends. In other words, the fee simple vests in the “remaindermen” on the death of the life tenant.

Reversion. The owner of land in fee simple may grant a lesser estate to someone else, such as a life estate. During the life estate, the owner’s remaining interest is a reversion. At the end of the life estate, the owner’s interest reverts back to the owner. Similarly, the lessor of property has an expectant estate (a reversion) because all property rights return to the lessor when the lease expires.

- (4) joint estate. This refers to joint tenancy or tenancy in common, as discussed at ¶3-160—¶3-190.

¶3-160 Joint tenancy and tenancy in common. Co-owners of land own the land either as joint tenants or as tenants in common. The interest of each co-owner covers the whole of the land and in neither case can the “tenant”³³ exclusively claim any specific part of the land held in common.

The common law rule is that co-owners hold land as joint tenants unless there are specific words in the transfer to indicate that they are to hold distinct shares in the land (ie provided the conveyance contains no “words of severance”). For example, a transfer stating “to A and B jointly” or “to A and B” creates a joint tenancy. If the transfer contains words of severance indicating that the holders are to have distinct shares (eg “to A and B in individual shares” or “to A and B equally”), a tenancy in common will arise.

— *Case example* —

A testator made a will leaving his estate to A and B “as Joint Tenants”. Later he altered his will with a codicil (¶3-700) to include C “equally as a

33. Derived from the law-French for holder.

Joint Tenant with the previously named [A and B] as Joint Tenants". The court held that because of the inconvenience and possible unfairness of a joint tenancy, the three took as tenants in common in equal one-third shares on the basis that the use of the word "equally" indicated that a tenancy in common was intended.

Re Leaver³⁴ —

Where the purchase money for a property is provided by the parties in unequal shares, equity may treat the parties as holding the land as tenants in common.

Legislation may confirm the presumption in favour of joint tenancy or rebut it. For example, Torrens title legislation generally confirms the presumption in favour of joint tenancy (*Real Property Act 1900* (NSW) sec 100).³⁵

"100(1) Two or more persons who may be registered as joint proprietors of an estate or interest in land under the provisions of this Act, shall be deemed to be entitled to the same as joint tenants."

Land co-owned under general law or old system title, however, is stated in some jurisdictions to be held by the co-owners as tenants in common (eg *Conveyancing Act 1919* (NSW) sec 26).³⁶

"26(1) In the construction of any instrument coming into operation after the commencement of this Act a disposition of the beneficial interest in any property whether with or without the legal estate to or for two or more persons together beneficially shall be deemed to be made to or for them as tenants in common, and not as joint tenants.

26(2) This section does not apply to persons who by the terms or by the tenor of the instrument are executors, administrators, trustees, or mortgagees, nor in any case where the instrument expressly provides that persons are to take as joint tenants or tenants by entireties."

Section 26(1) is to be read subject to the exceptions outlined in sec 26(2). The relationship between the Torrens title presumption and the presumption under general law has rarely been litigated.³⁷

34. [1997] 1 Qd R 55; noted (1997) 71 ALJ 911.

35. Corresponding to, eg *Transfer of Land Act 1958* (Vic) sec 30(2); *Real Property Act 1886* (SA) sec 74; *Transfer of Land Act 1893* (WA) sec 60; *Land Titles Act 1980* (Tas) sec 44; *Land Titles Act 1925* (ACT) sec 54; *Real Property Act 1886* (NT) sec 74; compare *Land Title Act 1994* (Qld) sec 56(2) (tenants in common), noted, eg, (1994) 68 ALJ 675.

36. Corresponding to, eg, *Property Law Act 1974* (Qld) sec 35; sec 26 is applied

in the ACT by *Law of Property (Miscellaneous Provisions) Act 1958* (ACT) sec 3.

37. The distinction is important where two persons contribute equally to the purchase price of property which is transferred into the name of one only in the circumstances where a resulting trust arises (as in a de facto relationship: ¶9-755). Equity regards the purchasers as joint tenants; if it applies, NSW sec 26 (and equivalents, *supra*) regards them as tenants in common.

The *Partnership Act* states explicitly that joint tenancy or tenancy in common does not of itself render the co-owners partners for the purposes of partnership law (§10-080).

¶3-180 Joint tenancy: the four unities. Joint tenants have separate legal rights between themselves, but are in the position of a single owner as against third parties.

In contrast to tenancy in common, joint tenancy is characterised by “the four unities”:

- (1) Unity of interest. Each co-owner must have the same kind of interest. The interests must be of equal size and of the same legal type. For example, a freeholder (holder of an estate in fee simple) and a tenant (under a lease) could not legally be joint tenants of land held jointly.
- (2) Unity of possession. Each co-owner has an equal right to possession and no co-owner holds any part of the land to the exclusion of the others. Unity of possession is the only “unity” applying equally to tenancy in common.
- (3) Unity of time. The interests of the joint tenants must vest in them at the same time.
- (4) Unity of title. The co-ownership must have been created by the same document (deed, will, etc), as all the joint tenants together constitute a single tenant.

Destruction of one or more of these four unities will end a joint tenancy. On the death of one joint tenant, that tenant’s interest passes to the surviving tenant(s) and this process continues until there is only one survivor who then becomes the sole owner.³⁸

Joint tenancy may also be terminated (“severed”) and converted into separate ownership or into a tenancy in common by:

- mutual agreement (also, a joint tenant may sever the joint tenancy by unilateral transfer to a third party, or to a trustee, if done effectively.)³⁹ A gift which is not effective in equity will not sever a joint tenancy;⁴⁰
- course of conduct;
- sale (ie a completed sale. A contract to sell does not sever a joint tenancy);

38. The distinction between joint tenants and tenants in common is overridden by the capital gains tax provisions of the *Income Tax Assessment Act 1936* (Cth). Those provisions apply as if an asset owned by persons as joint tenants were owned by those persons as tenants in common (sec 160ZN(1)).

39. eg *The Public Trustee v Pfeiffle* [1991] 1 VR 19 (words implying separate

interests construed as words of severance; evidence of common intention to sever). Unilateral action cannot destroy the unities of joint tenants: *Corin v Patton* (1990) 169 CLR 540, noted (1990) 64 ALJ 727.

40. eg *Costin v Costin*; ¶3-220.

- partition (where the co-owners agree to divide the property, each becoming sole owner of part of the property);
- alienation (transfer) or assignment by one of the joint tenants;
- merger (where a co-owner acquires an interest in the property larger than that held by the other co-owners);
- an order of the Family Court under sec 79 of the *Family Law Act 1975* (Cth) (“Alteration of property interests”) or the approval by the Family Court of a maintenance agreement entered into under sec 86 or sec 87 of that Act.
- homicide (a joint tenant who murders the other joint tenant cannot benefit from the crime).

¶3-190 Tenancy in common. Tenants in common have an undivided share and a separate interest in the land, although the land remains physically undivided. Their shares may be equal or unequal. A tenant in common can deal with that tenant’s own share separately, such as leaving it by will. No one tenant in common is entitled to the exclusive possession of any part of the land, and each is entitled to occupy the whole in common with the other co-owners. Accordingly, tenants in common do have unity of possession (as do joint tenants), but they may lack unity of interest, unity of time and unity of title.

In contrast to co-ownership of land as joint tenants, there is no right of survivorship in the case of tenancy in common. The share of a tenant in common does not pass to surviving tenants but instead passes to that tenant’s legal personal representative.

Tenancy in common may be terminated and converted into separate ownership by:

- sale;
- partition (dividing up the land);
- buying-out (where the land becomes vested in one tenant in common who buys out the share of the other/s).

¶3-195 Multi-ownership of land. Multi-ownership of land held under Torrens title and under general law/old system title (¶3-290ff) includes the following:

- (1) strata title;
- (2) company share ownership;
- (3) cluster title or community title;
- (4) time share;
- (5) retirement villages; and
- (6) mining and petroleum leases.

LEGAL AND EQUITABLE INTERESTS IN LAND —

Nature of common law and equity	¶3-200
Difference between legal and equitable interests	¶3-210
Creation and disposition of an equitable interest	¶3-220
Equitable interest under contract for sale of land	¶3-230
Interest held by beneficiary under a will	¶3-240
Equitable interest under option to purchase	¶3-250
Priorities between competing legal and equitable interests	¶3-270
Caveats	¶3-280

¶3-200 Nature of common law and equity. Equity has two meanings in law. Its original and general meaning is that of natural justice or fairness. Its modern technical legal meaning refers to the body of rules formulated and administered by Courts of Equity separate from and alongside the rules and procedures of the common law courts, as set out at ¶1-010.

¶3-210 Difference between legal and equitable interests. An interest in property fully recognised by the common law is a legal interest, such as the interest of a registered owner of land. Sometimes other people may have a claim to the land — an equitable interest — and conscience (or equity) may require that the legal owner recognise that interest. These interests were created by the equity courts, and they parallel legal interests, so there can be an equitable estate in fee simple, an equitable life estate, an equitable easement, an equitable mortgage (¶13-047), an equitable charge (¶13-048) and equities in respect of a trade mark (¶3-670).

Equity. The word “equity” has different meanings according to the context:⁴¹

- (1) an “equitable interest”. This is a right of ownership arising from a relationship between the parties enforced by equity but not by the common law (¶3-220). An “equitable interest” includes the interest of a beneficiary in a fixed trust (where the trustee has a “legal interest”: ¶3-220; ¶9-755; ¶9-760) and the interest of a partner in property of the partnership (¶10-390).

An “equitable interest” also refers to the interest in a deceased’s property which a beneficiary under a will or intestacy hopes to receive (¶3-240);

- (2) a “mere equity”. This is not an ownership or property right, but is a right recognised by equity which is usually of a procedural nature and is ancillary to a property right. Examples of a “mere equity” include:
 - the right to have a transaction set aside for fraud or undue influence (¶5-710), or

41. Adapted from Skapinker, D, *Equitable interests, mere equities, “personal” equities and “personal equities”* —

distinctions with a difference (1994) 68 ALJ 593.

- the right to have a document rectified for mistake (§5-691).

The right of the beneficiary of a discretionary trust is called a “mere expectancy” — this is a possibility (or a hope) at a level lower than that of a “mere equity”: §9-780. A “mere expectancy” is neither a right nor a claim.

- (3) an “equity”. For example, the interest of a beneficiary under a will or an intestacy in the property of the deceased (§3-240) is an “equity”.
- (4) a “personal” equity — the right of access to a court of equity to obtain an injunction or other equitable remedy, whether or not supported by a property right; and
- (5) a “personal equity” or the “right in personam” — this is the exception to the indefeasibility of title acquired by a proprietor of Torrens title land on registration (§3-300).

§3-220 Creation and disposition of an equitable interest.

An equitable interest in real or personal property includes:

- the interest of a beneficiary in a trust (where the trustee has a “legal interest”: §9-760);
- a contract on the part of the legal or equitable owner to assign the property or to enter a lease;⁴²
- the interest of the lessee of land, or of the purchaser of land (§3-230), in the land before final settlement (§3-450);
- a will, which gives an equitable interest to a beneficiary (§3-240);
- an option to purchase (§3-250);
- the interest of a partner in the property of the partnership (§10-390).

In each case, there must be clear intention on the part of the donor to effect a voluntary disposition of an equitable interest.

All jurisdictions have legislation, based on the *Statute of Frauds 1677* (§9-840), which requires a disposition of an equitable interest in land to be in writing signed by the person disposing of the interest or by a lawfully authorised agent.

Further, equity will not assist a volunteer, as confirmed in the rule in *Milroy v Lord*:⁴³

“I take the law of this Court to be well settled, that, in order to render a voluntary settlement valid and effectual, the settler must have done everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him.”

42. *Chan v Cresdon Pty Ltd* (1989) 168 CLR 242; (1989) 64 ALJR 111, noted (1990) 64 ALJ 353.

43. (1862) 4 De GF&J 264 at p 274; 45 ER 1185 at p 1189.

Therefore, if a voluntary settlement or gift does not fulfil legal requirements (such as the need for registration of legal ownership in the attempted one-sided severance of a joint tenancy in *Corin v Patton*: ¶13-180), equity law cannot make it effectual (¶13-340).

— *Case example* —

A (father) and B (his son) were joint tenants of a property under Torrens title. The certificate of title was held by solicitors on behalf of A and B. A decided to give his interest in the property to C (his other son), signed a transfer to C and gave it to C, with a direction to the solicitors to register the transfer to C. Believing they needed the authority of A and B to release the certificate of title, the solicitors did not register the transfer. Later A changed his mind, transferred his interest to B and the solicitors registered the transfer. C claimed that the gift to C was effective in equity, and that B held the property in trust for C.

The court held that the gift to C was not effective in equity as the two tests in the rule in *Milroy v Lord* (above) had not been fulfilled:

- (1) the settlor (A) *had* done all that was necessary to be done to transfer the property to C, but
- (2) the settlor *had not* done all that was necessary to be binding on him. A had not put the transfer beyond his recall, as the solicitors were unwilling to produce the certificate of title, so the second test had not been fulfilled.

— *Costin v Costin*⁴⁴ —

¶13-230 Equitable interest under contract for sale of land.

Where there is a valid contract for the sale of land and the vendor's obligation to transfer is enforceable by the courts, the vendor becomes trustee of the land for the purchaser. The purchaser, who becomes the beneficial owner of the land, has an equitable interest in the land which can be enforced by the equitable remedy of specific performance if the vendor fails to transfer the land (¶16-400). The purchaser can require transfer of the legal title when the purchase price is paid. On settlement, the vendor must transfer its legal title to the land to the purchaser.

Sometimes the contract may have a condition requiring an approval of, for example, the Minister before it can go ahead. If so, the purchaser does not have an equitable interest until the required condition is fulfilled. However, the purchaser does have an equity to go to the court for its assistance to force a vendor to do what must be done under the contract to secure fulfilment of the condition.⁴⁵

¶13-240 Interest held by beneficiary under a will. The interest in the property of the deceased which a beneficiary under a will or intestacy hopes to receive if the property is not required for the payment of debts or

44. (1997) NSW ConvR ¶55-811, noted (1997) 71 ALJ at p 912.

45. *McWilliam v McWilliams Wines Pty Ltd* (1963-1964) 114 CLR 656 at p 662.

other liabilities is called an “equity” or an “equitable interest” (§3-210). The status of the interest of a person who is a beneficiary under a will varies according to the progress of the administration of the deceased estate (§3-720—§3-730).

- A beneficiary in an unadministered estate has a right only “in respect of” assets in the estate and not an equitable interest “in” any of the assets or the totality of the assets until completion of the administration of the estate. The beneficiary’s interest is a right or a mere personal equity (a chose in action created by the will) to have the deceased estate administered in accordance with the duties of the executors.⁴⁶
- A beneficiary in a fully administered estate has a full equitable interest in the particular assets relevant to the benefit devised or bequeathed to the beneficiary under the will.⁴⁷

§3-250 Equitable interest under option to purchase. An option to purchase usually binds the grantor of the option to sell if it is exercised by the grantee (§5-365). The grantee of the option is not bound to purchase. Where an option imposes more than a personal obligation on the grantor and is binding on the grantor’s estate, it creates an immediate equitable interest in the land.⁴⁸

§3-270 Priorities between competing legal and equitable interests. Because the legal owner of property can sell the property, the legal owner is in a strong position to defeat any equitable interests over the property. The rights of the equitable owner, which can be destroyed by sale by the legal owner, are only enforceable against persons who acquire legal ownership of the property with the knowledge of the interest of the equitable owner.

Problems involving priorities of ownership can arise where:

- (1) there are two or more competing legal interests;
- (2) there are two or more competing equitable interests;
- (3) there is a legal interest and a subsequent competing equitable interest;
- (4) there is an equitable interest and a subsequent competing legal interest.

In short, most disputes can be determined by the following three principles.

46. *Livingston v Commissioner of Stamp Duties (Qld)* (1960) 107 CLR 411; *Official Receiver in Bankruptcy v Schultz* (1990) 170 CLR 306.

47. Further, a beneficiary under a will has standing to bring legal proceedings in the equitable jurisdiction of the court (§3-210) in exceptional circumstances

(such as alleged collusion between the trustee and a debtor of the estate, or the insolvency of the trustee): *Ramage v Waclaw* (1988) 12 NSWLR 84, noted (1989) 63 ALJ 51.

48. eg *O’Neill v O’Connell* (1945-1946) 72 CLR 101 at pp 119, 129.

(1) *Nemo dat quod non habet* (one cannot give what one does not have), discussed at ¶17-020.

First example: If A (the legal owner) has effectively conveyed an estate in fee simple to B, a later conveyance by A to C of the property is void under the general law. However, if the conveyance to C is bona fide and for valuable consideration on C's behalf, and is registered (under registration of deeds or under Torrens title legislation) before the conveyance to B is registered, C's interest is effective and gains priority over B's interest. If B registered his interest before C, C is taken to know of the existence of B's interest.

Second example: If A (the legal owner) has sold or mortgaged the land to B, and later C sells or mortgages the same land to D, there is no priority problem. As C never had title, D cannot obtain priority through earlier registration and D could only obtain priority where C has derived title through A (by conveyance or by operation of law).

(2) *Qui prior est tempore potior est jure* (the person who is first in time has the stronger legal claim). Between competing equitable interests, if the merits are equal the first in time prevails. If the merits are unequal, the person with the stronger equity may take priority even if that person's interest was created later in time.

— *Case example* —

Competing unregistered interests in Torrens title land. In a dispute between P, the unpaid seller (with a vendor's equitable lien for payment: ¶13-280) and D, the unregistered mortgagee (therefore an equitable mortgagee: ¶13-047), the High Court held in favour of D. P had delivered to an employee of its buyer the signed contract of sale and a signed memorandum of transfer wrongly stating that payment for the sale had been received in full. P believed the employee to be a solicitor acting for P and D. The buyer then borrowed on the security of a mortgage of the land to D, and D advanced funds on the basis of the title and P's signed transfer. Although P's equitable interest was first in time, the High Court acting on the basis of fairness and justice made a rational and justifiable allocation of loss and held that it would have been inequitable for P to retain its earlier priority. It should have been reasonably foreseeable to P that a later equitable interest might be created and that the holder of that later interest (D) would assume the non-existence of the earlier interest.

— *Heid v Reliance Finance Corporation Pty Ltd*⁴⁹ —

(3) *Where the equities are equal, the law prevails.* On this basis, the legal estate will generally override subsequent equitable interests. The holder of a later equitable estate must establish that the equities are unequal and are in his favour in order to render the legal estate subject to his interest acquired later in time. Fraud or gross negligence would be such instances. In the converse situation, when an equitable interest competes with a subsequently

49. (1983) 154 CLR 326; (1983) 57 ALJR 683.

created legal interest, the legal interest will have priority if the purchaser of the estate has:

- given valuable consideration for the property;
- acquired legal ownership;
- received no notice — actual or constructive — of the earlier equitable interest attaching to the property;
- acted bona fide (in good faith), and has made reasonable inquiries to determine the existence of any equitable interests.

The application of these principles to old system/general law land is affected by registration of deeds legislation, providing that:⁵⁰

“[a]ll instruments ... affecting ... any lands ... which are executed or made bona fide, and for valuable consideration, and are duly registered ... shall have and take priority not according to their respective dates but according to the priority of the registration thereof only.”

Similarly, Torrens title legislation must be read in conjunction with these common law and equity principles.

Practical problems generally do not involve an abstract application of these principles, and usually arise where there are competing registered and unregistered documents.

¶3-280 Caveats. A caveat is a written warning, or an entry made in a register, to prevent action without notice being given to the person who lodged it (the caveator). A caveat operates like an injunction (¶6-410; ¶8-810). A caveat may be lodged by a person holding a legal or equitable interest in land, by the Registrar-General, Registrar of Titles or equivalent, and by creditors in some jurisdictions (¶13-120).

— *Case example* —

Borrower signed a mortgage in registrable form and deposited the duplicate certificate of title with the bank (D) as security for an overdraft. The bank did not register the mortgage. Three years later Borrower borrowed from P, and P took a signed mortgage and the certificate of title as security. Borrower explained to P that the duplicate was with the bank for safekeeping, and P's solicitor found no encumbrances registered on the title. P lodged a caveat to protect its interest. When the bank lodged its mortgage for registration, P's claim of priority failed: the bank's failure to lodge a caveat did not necessarily involve loss of priority, and the bank was entitled to rely on its possession of the duplicate and the Registrar-General's practice of refusing to accept a mortgage for registration without the duplicate.

The purpose of a caveat was set out by the High Court in these words:

50. *Conveyancing Act 1919* (NSW) sec 184G(1); *Property Law Act 1958* (Vic) sec 6; *Property Law Act 1974* (Qld) sec

241-249; *Registration of Deeds Act 1935* (SA); 1856 (WA); 1935 (Tas); 1957 (ACT).

“Its [a caveat’s] purpose is to act as an injunction to the Registrar-General to prevent registration of dealings with the land until notice has been given to the caveator. This enables the caveator to pursue such remedies as he may have against the person lodging the dealing for registration. The purpose of the caveat is not to give notice to the world or to persons who may consider dealing with the registered proprietor of the caveator’s estate or interest though if noted on the certificate of title, it may operate to give such notice ... the purpose of the caveat is protective: it is not to give notice.”

———— *J & H Just (Holdings) Pty Ltd v Bank of New South Wales*⁵¹ —

Examples of caveats include:

- (1) a caveat by a person claiming an estate or interest in land (¶13-155) forbidding the bringing of land under Torrens title;
- (2) a caveat by the Registrar-General or equivalent on behalf of a person under any legal disability, or on behalf of the Crown to prohibit the transfer of land;⁵²
- (3) a caveat by a person with a recognised “caveatable interest” such as:
 - the registered proprietor of land,⁵³
 - the purchaser of land (¶13-230),
 - the grantee of an option to purchase an interest in land (¶13-250),
 - a person entitled to the benefit of an easement or a restrictive covenant (¶13-450),
 - a beneficiary in land owned by the trust (¶9-800),
 - a partner in partnership land (¶10-390),
 - a person entitled to a mortgage or charge (¶13-040—¶13-048),⁵⁴
 - creditors in some jurisdictions to prevent registration of a bill of sale until a court hearing is held to determine claims (¶13-120).

There are many different categories of caveatable interest. A “caveatable interest” is a proprietary interest, and it does not include a purely contractual or personal right. Caveatable interests have been held to exclude the claim of a purchaser under a conditional contract, the claim of a deserted wife, and a licence to occupy land.

51. (1971) 125 CLR 546 at pp 552 and 556.

52. eg *Real Property Act 1900* (NSW) sec 12(1)(e); *Transfer of Land Act 1958* (Vic) sec 106(a); *Land Title Act 1994* (Qld) sec 122(1)(b); *Real Property Act 1886* (SA) sec 220(5).

53. eg Wright, D, *Does the registered proprietor have a caveatable interest?*

(1995) 69 ALJ 935, where the author answers “yes”.

54. eg *Pacific Homes Ltd (in receivership) v Consolidated Joineries Ltd* [1996] 2 NZLR 652, noted (1997) 71 ALJ at p 585.

OWNERSHIP OF LAND: TORRENS TITLE AND GENERAL LAW/OLD SYSTEM TITLE _____

Ownership of land	¶3-290
Ownership of land: (1) Torrens title	¶3-300
Priorities under Torrens title	¶3-360
Ownership of land: (2) general law or old system title ...	¶3-370
Defining a good root of title	¶3-380
Registration of deeds legislation	¶3-410
Priorities under the general law/old system title	¶3-420
Native title	¶3-425

¶3-290 Ownership of land. Ownership of land is under either Torrens title or old system/general law title. Ownership of land under Torrens title is discussed at ¶3-300—¶3-360 while ownership of land under general law, common law or old system title is discussed at ¶3-370—¶3-420. The general procedures for a conveyance of real property are set out at ¶3-450.

For historic reasons, regulation of land is divided between Commonwealth, State or Territory jurisdictions with respect to land titles registration procedures, land tax, stamp duty, town planning, tenancy law (commercial, retail and domestic), development procedures and conveyancing practice.

Mortgages of land under the two systems of land ownership are discussed at ¶13-040—¶13-045.

“Native title” is discussed at ¶3-425.

¶3-300 Ownership of land: (1) Torrens title. The Torrens system is the name given to the system of land ownership under which land ownership passes not by execution of deeds but by the registration of dealings on a public register maintained by the Registrar-General. The system is named after its early advocate, Robert Torrens, who became Premier of South Australia in 1858. The Torrens system became law in that State as a result of the *Real Property Act 1858* (SA). The system spread to other jurisdictions within a short period.⁵⁵

Torrens title legislation⁵⁶ aims to overcome the difficulties of conveyancing and land ownership under general law or old system title (¶3-370ff).

Torrens title is based on land, not people. The basic unit used in the Torrens title system to record title and changes of ownership is the parcel of land

55. Many other countries have adopted the Australian Torrens system of land registration such as Malaysia and Singapore: *Torrens around the world* (1999) 73 ALJ 18.

56. *Real Property Act 1900* (NSW); *Transfer of Land Act 1958* (Vic); *Land Title Act*

1994 (Qld); *Real Property Act 1886* (SA); *Transfer of Land Act 1893* (WA); *Land Titles Act 1980* (Tas); *Land Titles Act 1925* (ACT); *Real Property Act 1886* (NT).

itself rather than the person holding an interest in that parcel. The parcel of land is the basis of the record against which the interests of various persons are registered. By way of contrast, a deed under general law passes an interest in land from person to person, and registration of deeds provides evidence of the transactions that have taken place with the land.

Torrens title achieves a more accurate definition of the land and the nature and extent of interests over it than do the deeds used under the general law.

Torrens title is based on four general principles:⁵⁷

(1) *The “mirror” principle* — the Register and the certificate of title accurately and completely reflect all legal interests relevant to the title of the parcel of land.

Title by registration. Under the Torrens system, registration itself vests title to an interest in land in the owner, called the “registered proprietor”. (In contrast, ownership under general law or old system title is a system of registration of an already existing title which exists quite independently of registration: ¶3-370.) The Torrens system is:

“not a system of registration of title but a system of title by registration. That which the certificate of title describes is not the title which the registered proprietor formerly had, or which but for registration would have had. The title it certifies is not historical or derivative. It is the title which registration itself has vested in the proprietor. Consequently, a registration which results from a void instrument is effective according to the terms of the registration.”⁵⁸

The effect of the Torrens system is that:

- (a) registration cuts off the retrospective or derivative character of the title on each transfer so that the owner is in the same position as a grantee direct from the Crown;⁵⁹
- (b) the certificate (or duplicate certificate) of title is conclusive proof of the title of the registered proprietor so that no other person can claim to be the proprietor of the title to which the certificate relates;
- (c) the Register is evidence of the particulars it records, which are immune from being found null and void (“defeasance”) by a first (or “paramount”) title, and
- (d) priority (¶3-360) is given by the registration of the transfer of title.

57. Ruoff, TBF, *An Englishman Looks at the Torrens System*, Sydney, The Law Book Co Ltd, 1957, p 8; Moerlin Fox, P, *The story behind the Torrens system* (1950) 23 ALJ 489.

58. *Breskvar v Wall* (1971) 126 CLR 376, per Barwick CJ at pp 385-386.

59. Torrens, R, *A Handy Book on the Real Property Act of South Australia*, 1862, p 11, quoted in *Leros v Terara Pty Ltd* (1992) 66 ALJR 399 at p 403.

The Torrens title system has achieved a considerable improvement in land conveyancing over conveyancing under general law or old system title and has resulted in a greater certainty of title. The use of prescribed standard form documents for land dealings facilitates transfer, reduces delay and expense and results in simplification of conveyancing. There are still, however, many precautions to be taken in a conveyance of Torrens title land, as outlined at ¶3-450.

The Register. The Register maintained by the Land Titles Office (or equivalent) is of central importance to title registration and to the operation of the Torrens system. It consists of folios, dealings, instruments and other records which identify the land, its owner, and others with rights to it such as mortgagees. With increasing computerisation of land information, title searches and all administrative information about land will be available from one "shop front".

As affirmed by the Privy Council in 1926,⁶⁰ the chief principle of the legislation is that "the register is everything". Although this statement may be subject to some exceptions, it certainly reflects the objective of the Torrens title system.

Three important consequences flow from these comments.

- (a) It should not be necessary to investigate the history of the registered proprietor's title.
- (b) A party should be able to deal safely by relying on the accuracy of the Register. This is the "mirror" principle referred to above.
- (c) In the absence of fraud or bad faith, a person dealing on the faith of the accuracy of the Register should be able to obtain a good title, upon registration of the dealing, unaffected by—
 - earlier defects of title, and
 - defects in the dealing conveyed, or
 - defects in the capacity of the conveyer to transfer title.

(2) *The "curtain" principle* — a purchaser only needs to search the title on the Register and does not need to go behind the curtain by inquiring into interests which are not disclosed on the Register.

State registration of title. Registration of land is an act authorised and carried out by the State and not by the parties themselves.⁶¹

"It is not the parties who effectively *transfer* the land, but it is the State that does so, and in certain cases more fully than the party could." The State guarantees title and compensates people who incur loss through the operation of the Torrens title system. A fund is provided by the legislation to compensate

60. *Waimiha Sawmilling Co Ltd (in liq) v Waione Timber Co Ltd* [1926] AC 101 at p 106.

61. *Commonwealth of Australia v State of New South Wales* (1918) 25 CLR 325, per Isaacs and Rich JJ at p 342.

people who, through no fault of their own, have been deprived of their property through, for example, fraud.

(3) *The “insurance” principle* — a person deprived of an interest or incurring loss through the operation of the Torrens system may claim compensation from the State. The legislation sets up an assurance fund and provides a statutory cause of action so that a person may recover compensation for loss caused by such matters as fraud; bringing the land under Torrens title; registration of any other person as proprietor; or error, omission or misdescription in the Register.⁶²

(4) *The “indefeasibility” (undefeatability) principle* — a registered title is indefeasible, and a person acquiring an interest on the faith of the Register obtains title free from trusts, equities and unregistered interests and is protected by the application of the principle of immediate indefeasibility of title (subject to exceptions discussed below). A basic concept of the Torrens system is that title held under a registered interest is “indefeasible”. Although this expression does not appear in Torrens title legislation, it has been described by the courts as:⁶³

“... a convenient description of the immunity from attack by adverse claim to the land or interest in respect of which he is registered, which a registered proprietor enjoys. This conception is central in the system of registration. It does not involve that the registered proprietor is protected against any claim whatsoever ... But as registered proprietor and while he remains such, no adverse claim (except as specifically admitted) may be brought against him.”

Indefeasibility can be described as follows:⁶⁴

“... the conclusiveness of the certificate of title is definitive of the title of the registered proprietor. That is to say, in the jargon which has had currency, there is immediate indefeasibility of title by the registration of the proprietor named in the register.”

The quality of indefeasibility has been described by judges as “unimpeachable”, “conclusive”, “absolute”, “unexaminable” and “unassailable”. In view of the exceptions (discussed below) to the conclusiveness of the Register, Professor Whalan suggests that “indefeasible” is a misnomer which would be more suitably replaced by the expression “State-guaranteed”.⁶⁵

62. *Real Property Act 1900* (NSW) sec 126; *Transfer of Land Act 1958* (Vic) sec 110; *Land Title Act 1994* (Qld) sec 173, noted eg (1994) 68 ALJ at pp 679-680; *Real Property Act 1886* (SA) sec 203; *Transfer of Land Act 1893* (WA) sec 201; *Land Titles Act 1980* (Tas) sec 152; *Real Property Act 1925* (ACT) sec 154.

63. *Frazer v Walker* [1967] 1 AC 569 at pp 580-581.

64. *Breskvar v Wall* (1971) 126 CLR 376, per Barwick CJ at p 385.

65. Whalan, DJ, *The Torrens System in Australia*, The Law Book Co Ltd, 1982, pp 296-297.

— *Case example* —

Immediate indefeasibility

Mr and Mrs P were registered proprietors of a farm. Mrs P executed a mortgage to X, forging Mr P's signature. Upon default, X exercised its power of sale as mortgagee, selling by auction to D. Mr P's action as registered proprietor against D for possession failed: both the mortgage to X (which was registered) and the transfer to D were effective, notwithstanding the forged signature on the mortgage.

*Frazer v Walker*⁶⁶ —

There are exceptions to the principle of indefeasibility, such as the following:

Fraud. Torrens title legislation provides that fraud is an exception to the absolute and indefeasible title of a person holding land under Torrens title. The legislation protects the title of a registered proprietor who has taken bona fide for valuable consideration or any person in good faith claiming through the registered proprietor.

However, fraud for the purposes of the Torrens system (statutory fraud) is more restricted than fraud at general law:⁶⁷

- (1) Statutory fraud covers less not more than fraud at general law, and
- (2) Statutory fraud is not to give legal rights and obligations, but to qualify the operation of the doctrine of indefeasibility.

For example, assume a purchaser of unregistered land knows of an antecedent interest:

- (1) Under equity law, the purchaser generally takes subject to an antecedent interest of which the purchaser has notice.
- (2) Under the Torrens system, registration of a transfer is not fraudulent merely because the transferee knows that registration will defeat an antecedent unregistered interest of which the transferee has notice.

— *Case examples* —

Fraud. Facing insolvency, Mr and Mrs P (P) (owners of lots 221 and 340 in the seaside town of Cervantes, WA) decided to raise finance by selling lot 340 to Purchaser 1 on a sale and leaseback contract with a buy-back clause enabling repurchase after three years by P, 30 days after payment of deposit. About one year later, Purchaser 1 sold lot 340 to D, subject to the three-year buy-back. As registered proprietor, D argued that indefeasibility of title superseded any contractual rights and refused to retransfer to P. Ordering specific performance, this view was rejected by the High Court: D, by taking the transfer with notice of P's equitable interest (though confidently expecting that P would not be able to afford to exercise the buy-back) held lot 340 as trustee in favour of P.⁶⁸ Repudiation of the agreement by D constituted

66. [1967] 1 AC 569.

67. *Bank of South Australia Ltd v Ferguson* (1998) 72 ALJR 551 at p 554.

68. An express trust in the view of *Mason* CJ and *Dawson* J; a constructive trust by *Wilson, Toohey and Brennan* JJ; ¶9-755.

either fraud (*Mason* CJ and *Dawson* J), bad faith, or breach of a collateral contract (¶16-030).

— *Bahr v Nicolay (No 2)*⁶⁹ —

Omission of easement. An easement registered on the certificate of title of the dominant tenement, but not on the title of the servient tenement when it was later brought under Torrens title, fell within one of the exceptions to Torrens title indefeasibility.

— *Parramore v Duggan*⁷⁰ —

There are exceptions to the indefeasibility of title under the Torrens system in other legislation, such as land vesting in the local council for drainage, land resumption for public roads and so on, statutory easements in favour of water authorities, imposition of rates and charges on land, mining and petroleum tenure (¶13-150) and legislation relating to forests and water resources.

Personal equity exception. A Torrens title transaction may be declared void if there is a “personal equity” (¶13-210) or an “*in personam* claim” between the registered proprietor and another person. The indefeasibility principle created by the Torrens system “in no way denies the right of a plaintiff to bring against a registered proprietor a claim *in personam*, founded in law or in equity, for such relief as a court acting *in personam* may grant”.⁷¹

Unconscionable conduct (for example, under *Amadio's case*: ¶15-730) may be grounds for an *in personam* claim or a claim in fraud under the Torrens system, but it is not a sufficient basis in itself,⁷² as the title of a registered proprietor under Torrens title cannot be defeated by evidence of unconscionable conduct without an established legal or equitable cause of action under the Torrens system.

Constructive trust. A constructive trust may be imposed on a registered proprietor of land under Torrens title to hold the land subject to the rights of beneficiaries: ¶9-755.

— *Case example* —

Personal equity. Where a husband forged his wife's signature on an increase in their mortgage and kept the increase, the wife was entitled to have the increase set aside. Her personal equity — her equity of redemption under the original mortgage (¶13-040) — was enforceable against the mortgagee. The wife's personal equity survived her husband's registration of the increase of the mortgage.

— *Mercantile Mutual Life Insurance Co Ltd v Gosper*⁷³ —

69. (1987-1988) 164 CLR 604; (1988) 62 ALJR 268, noted (1988) 62 ALJ 1036.

70. (1995) 70 ALJR 1, noted (1996) 70 ALJ 346.

71. *Frazer v Walker* [1967] 1 AC 569 at p 585.

72. eg *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd* (1997) V ConvR ¶54-572, noted (1998) 72 ALJ 258.

73. (1991) 25 NSWLR 32, later developments noted (1994) 68 ALJ 448; Robinson, S, *Claims in personam in the Torrens system: some general principles* (1993) 67 ALJ 355.

¶3-360 Priorities under Torrens title. As discussed at ¶3-300, a person acquiring an interest on the faith of the Register obtains title free from unregistered interests. An unregistered interest can be protected by:

- registration;
- lodging a caveat on the folio of the Register (¶3-280);
- ensuring that actual or constructive notice be acquired by persons dealing with the land in the future.

Priorities between competing unregistered interests can be determined as follows:

- (1) The earlier of two unregistered interests is entitled to priority by reason of having been created earlier.
- (2) That priority cannot be lost against the holder of a later unregistered interest who had received actual or constructive notice of the earlier interest when or before acquiring that later interest.
- (3) If the holder of the later unregistered interest has acquired it for value and without notice of the earlier interest, attention should be focused on the conduct of the holder of the earlier unregistered interest to determine whether that interest should be postponed to the later interest.
- (4) Where—
 - (a) a later unregistered interest has been acquired without notice of an earlier interest, and
 - (b) there are circumstances in which the earlier interest might be postponed, such as fraud, gross negligence or estoppel,
 then the court must consider the conduct of both parties and the whole of the circumstances.
- (5) If the conduct of the holder of the earlier interest enables the court to consider the conduct of each competing claimant and all the surrounding circumstances, the court must ultimately determine which party has the better claim to equitable relief and whether the earlier interest should be postponed.

¶3-370 Ownership of land: (2) general law or old system title. Ownership of land under the general law or old system title¹ is proved by tracing ownership back to an unchallengeable beginning. Originally, this unchallengeable beginning meant a land grant by the government exercising sovereign power (a Crown grant) and, as all Crown grants have been issued under Torrens title since the introduction of Torrens title legislation, the source of existing general law or old system titles to land must be a Crown grant well over 100 years old.

1. Sykes and Walker prefer “old title land” instead of the “‘objectionable’ phrase ‘old system land’”, which suggests that land was

held under some legislatively systematised scheme”: *The Law of Securities*, LBC, 5th ed, 1993, p 39.

On a sale of land the vendor must prove title to the land being sold. However, statute law has modified the need to trace and prove ownership back to the Crown grant. In most jurisdictions legislation provides that "thirty years shall be substituted as the period of commencement of title which a purchaser may require".²

¶3-380 Defining a good root of title. Title to land does not commence exactly 30 years before the date of a contract of sale or the time of investigating the title. Rather, it commences at a date, at least 30 years previously, when the chain of title first included an instrument constituting a good root of title.

A document constituting a good root of title has been defined as:³

"... an instrument of disposition dealing with or proving on the face of it (without the aid of extrinsic evidence) the ownership of the whole legal and equitable estate in the property sold, containing a description by which the property can be identified, and showing nothing to cast any doubt on the title of the disposing parties".

Problems arise in determining whether a document does in fact constitute a good root of title. It has been suggested that the definition contains six requirements to be proved in order that a particular instrument may be relied on as a good root of title:⁴

- (1) ... *an instrument of disposition, such as a conveyance of a legal estate in fee simple.* A will is not such an instrument of disposition.
- (2) ... *dealing with the ownership of the whole legal and equitable estate in the property sold.* A first legal mortgage deals with the ownership of the whole legal and equitable estate because it conveys the legal estate and reserves the equitable estate. Together these comprise the whole estate.
- (3) ... *proving on the face of it the ownership of the whole legal and equitable estate in the property sold.* A transfer of a legal mortgage in which the mortgagor is joined to confirm the mortgagor's title, although not dealing with the whole legal and equitable estate, may be considered adequate.
- (4) ... *without the aid of extrinsic evidence.* Although an executor, trustee or mortgagee may have a power of sale, the document of conveyance

2. eg *Conveyancing Act 1919* (NSW) sec 53(1); *Property Law Act 1958* (Vic) sec 44(1); *Property Law Act 1974* (Qld) sec 237(1); *Sale of Land Act 1970* (WA) sec 22; *Conveyancing and Law of Property Act 1884* (Tas) sec 35 (20 years); in South Australia, in the absence of legislation, the common law obligation to invest title remains at 60 years.

3. Williams, TC, *A Treatise on the Law of Vendor and Purchaser*, Sweet and Maxwell, 3rd ed, 1922, p 39; 4th ed, 1936, p 47.

4. Tebbutt, HW, *Roots of Title* (1975) 49 ALJ 86 at pp 91-92.

would not show this without extrinsic evidence; hence, such a conveyance would not qualify as a good root of title.

- (5) ... *containing a description by which the property can be identified.* A description in the instrument by reference to some other deed would be inadequate.
- (6) ... *and showing nothing to cast doubt upon the title of the disposing party.* Any assertion in a document explicitly or implicitly casting doubt upon the title of the disposing party would disqualify that document as a good root of title.

Instruments which may be a good root of title. A good root of title proves the ownership of the legal and equitable estate in the land. Only two instruments provide a good root of title — a conveyance of the whole legal and equitable (§3-210) interest in the land by the absolute owner (containing a sufficient description of the land), and a first legal mortgage (containing a sufficient description of the land).

Instruments which do not constitute a good root of title. Each of the following has been held not to constitute a good root of title:

- a general or specific devise by will (§3-700);
- a grant of probate or letters of administration (§3-720);
- a second or later mortgage (§13-040 — §13-047);
- a discharge of mortgage;
- an instrument dealing with an estate in land less than the fee simple (such as a life estate or lease);
- a conveyance of the mortgagor's equity of redemption (such as the sale of land subject to an outstanding first legal mortgage).

§3-410 Registration of deeds legislation. A system of registration with the Registrar-General's Department, or equivalent, of instruments affecting title has been grafted on to the general law to provide some public notification of general law land dealings. Unlike Torrens title, this legislation does not provide for legal validity by registration of title.⁵ Instruments which can be registered include deeds transferring title and deeds of mortgage.

The effects of registration of deeds are to:

- provide evidence of validity. Sometimes other legislation requires certain instruments to be registered in order to be valid, such as a discharge of mortgage.

5. *Conveyancing Act 1919* (NSW) Pt 23 Div 1; *Property Law Act 1958* (Vic) Pt I; *Property Law Act 1974* (Qld) sec 241-249; *Registration of Deeds Act 1935* (SA);

Registration of Deeds Act 1856 (WA); *Registration of Deeds Act 1935* (Tas); *Registration of Deeds Act 1957* (ACT); *Registration Act 1980* (NT).

- provide evidence of the contents of the document.
- obtain priority over unregistered claimants to the land (§3-420). This is relevant where there are competing instruments over the same land.

§3-420 Priorities under the general law/old system title.

Documents which are registered (or capable of being registered) under the registration of deeds legislation take effect according to their dates of registration. In contrast to land under Torrens title, registration is relevant only to priority between competing interests, and legal title under general law can pass independently of registration.

For example, if a second mortgagee of general law land does not register the mortgage, a later buyer who registers a deed of transfer is not affected by the earlier unregistered mortgage. (The first mortgagee normally retains the title deeds as security.) If the mortgage is registered, the later buyer will not acquire clear title.

Principles governing priorities in relation to interests in Torrens title land are outlined at §3-360. Priorities between competing legal and equitable interests are set out at §3-270.

§3-425 Native title. In 1992, in *Mabo's case*⁶ the High Court recognised the concept of “native title” in Australia. The Court held that when the Crown acquired sovereignty over Australia in 1788 the ownership of the Crown was subject to the “interests and rights of indigenous inhabitants in land whether communal, group or individual, possessed under the traditional laws acknowledged by and the traditional customs observed by the indigenous inhabitants”.⁷

Before *Mabo's case*, Australian land law was based on the proposition that because Australia was originally a “settled colony” (settled by the British in 1788: §1-455) as opposed to a conquered colony, the first settlers brought with them as much of the English common law as was relevant in the colony at the time. Australia was seen as a “terra nullius” or unoccupied land, with no local law in existence.

The High Court rejected this “terra nullius” view in *Mabo's case* and held that:

- the Crown's acquisition of sovereignty over Australia by annexation could not be challenged but the Crown did not acquire ownership of the land, although when Australia was annexed by the British Crown, the land was treated as the property of the King to be granted or transferred to early settlers. The acquisition of the territory of Australia by the Crown is governed by international law; the acquisition of land

6. *Mabo v Queensland (No 2)* (1992) 175 CLR 1; §1-455. The *Native Title Act 1993* (Cth) gives statutory recognition to the *Mabo* principle.

7. *Mabo v Queensland (No 2)* (1992) 175 CLR 1 at p 57.

is governed by the common law. “[T]he distinction between sovereignty and title to or rights in land is crucial ...”⁸

- native title survived the acquisition of sovereignty by the Crown.
- native title can be extinguished if it can be shown that the sovereign power had been exercised over the land in a way inconsistent with the continuation of the native title — for example, by a grant of ownership (freehold).

Immediately the first British settlers arrived in Sydney in 1788, they began to take possession of the land on the basis that it was “terra nullius” and so began the “dispossession of the original inhabitants”: in the words of *Deane and Gaudron JJ*, “[t]he acts and events by which that dispossession in legal theory was carried into practical effect constitute the darkest aspect of the history of this nation. The nation as a whole must remain diminished unless and until there is an acknowledgment of, and retreat from, those past injustices.”⁹

The decision in *Mabo’s case* has been tested in the following situations:

- (1) *Pastoral leases*. Pastoral leases granted under State legislation do not of themselves extinguish native title existing in the leased land. “To say that the pastoral leases in question did not confer rights to exclusive possession on the grantees is in no way destructive of the title of those grantees. It is to recognise that the rights and obligations of each grantee depend on the terms of the grant of the pastoral lease and upon the statute which authorised it.”¹⁰
- (2) *Freehold*. Native title is extinguished by a freehold grant of land (an unqualified grant in fee simple), as common law native title is a personal right not supported by any actual or presumed Crown grant. A Crown grant is a valid exercise of sovereign power. Native title is not an estate in or an interest in land, and the personal rights of native title holders are inconsistent with the rights given by a freehold grant of land.¹¹

Understanding native title and its possible extinguishment is a new area of property law. In the words of *Kirby J*,¹² the search for extinguishment “is a search conducted at a disadvantage because it relies upon legal materials written in a completely different legal environment of contrary understandings and beliefs ... the present must revisit the past to produce a result, wholly unexpected at the time, which will not cause undue collision and strife in future.”

Native title legislation. The *Native Title Act 1993* (Cth)¹³ gives effect to the *Mabo case*. In the words of its preamble (¶1-230), it was passed to rectify

8. *Ibid* at p 180.

9. *Ibid* at p 109.

10. *Wik Peoples v Queensland* (1996) 187 CLR 1, per *Toohy J* at p 132; ¶1-540.

11. *Fejo v Northern Territory* (1998) 72 ALJR 1442, noted (1998) 72 ALJ 911.

12. *Wik Peoples v Queensland* (1996) 187 CLR 1 at p 230.

13. As amended by the *Native Title Amendment Act 1998* (Cth); Second Reading Speech, Hansard, House of Representatives, 9 March 1998.

past injustices, to secure the advancement and protection of Aboriginal peoples and Torres Strait Islanders and to ensure that they receive the full recognition and status to which history, their prior rights and interests and their rich and diverse culture fully entitle them to aspire. It is designed to provide certainty to the rules dealing with the extinguishment of native title.

“Native title” or “native title rights and interests” are defined to mean “the communal, group or individual rights and interests of Aboriginal peoples or Torres Strait Islanders in relation to land or waters, where:

- (a) the rights and interests are possessed under the traditional laws acknowledged, and the traditional customs observed ...; and
- (b) the Aboriginal peoples or Torres Strait Islanders ... have a connection with the land or waters; and
- (c) the rights and interests are recognised by the common law of Australia” (common law rights and interests: sec 223).

The concept of native title may change as the common law evolves in this area.

The aims of the legislation are set out in sec 3:

“Main objects

The main objects of this Act are:

- (a) to provide for the recognition and protection of native title; and
- (b) to establish ways in which future dealings affecting native title may proceed and to set standards for those dealings; and
- (c) to establish a mechanism for determining claims to native title; and
- (d) to provide for, or permit, the validation of past acts, and intermediate period acts, invalidated because of the existence of native title.”

The foundation sections of the Act are sec 10, which recognises and protects native title and sec 11, which states that native title is not able to be extinguished contrary to the Act.

In short,

(1) The Act validates:

- “past acts” — those acts before 1994 which extinguished native title: Part 2 Div 2. These “past acts” are defined in four classes:
 - a “category A past act”, which includes freehold estate and certain leases such as commercial leases, agricultural leases and pastoral leases (sec 229);
 - a “category B past act”, which refers to all leases except those in category A or category C (sec 230);
 - a “category C past act” — a mining lease (sec 231);
 - a “category D past act” — a catch-all covering, for example, fishing or tourism licences (sec 232).
- “intermediate period acts” — those from 1994 to 1996 — the period

between the commencement of the original *Native Title Act* and the *Wik case*: Part 2 Div 2A. This validates action taken by governments and others because of the legitimate and reasonable assumption that the act, such as a pastoral lease, extinguished native title. These are also classified into the same four classes as for past acts (sec 232B-232E).

- (2) The Act confirms the “past extinguishment of native title by certain valid or validated acts”, such as by freehold land or leases or by the construction of public works before December 1996: Part 2 Div 2B.
- (3) The Act provides that to the extent that a “future act” affects native title, it will be valid if it complies with the Act and invalid if it does not: Part 2 Div 3. Such acts are covered by the non-extinguishment of native title principle in sec 238.

Indigenous land use agreements. An ILUA is a legally binding agreement made between the native title holders and other groups such as government and miners (Part 2, Div 3, Subdiv D). It does not extinguish native title, and has the effect of a contract when registered with the Native Title Registrar (sec 24EA).

Applications for native title determinations. Applicants must apply to the Federal Court under Part 3 for a determination of native title, and compensation may be claimed for acts affecting native title under Part 2 Div 5: sec 13. In particular, entitlement to compensation is “an entitlement on just terms to compensate the native title holders for any loss, diminution, impairment or other effect of the act on their native title rights and interests”: sec 51.

Native title claims must be registered on the Register of Native Title Claims to gain the statutory rights under the Act. For registration, an applicant must satisfy the tests for native title set out in sec 190B(5) — association with the area, support of traditional laws and customs, and continuing to hold the native title in accordance with those traditional laws and customs. The Act provides for physical connection under the “stolen children” and the “locked gates” clause if at least one member of the native title claim group “previously had and would reasonably have been expected currently to have a traditional physical connection with any part of the land or waters but for things done ... by ... the Crown in any capacity ... or a statutory authority of the Crown ... or ... any holder of a lease over any of the land or waters” (sec 190B(7)).

ACQUIRING OWNERSHIP OF REAL OR PERSONAL PROPERTY

Transfer of ownership of property	¶3-430
Transfer of ownership of real property	¶3-440
A conveyance of real property: the general procedure ...	¶3-450
Transfer of ownership of personal property	¶3-460

¶3-430 Transfer of ownership of property. In our economy, based on private ownership of property, we take for granted that ownership of property can be freely transferred by various methods including purchase and sale. This form of transfer is, however, only one of many means of transfer.

Transfer of ownership of property can be accomplished by the methods set out in ¶3-440—¶3-460 below.

¶3-440 Transfer of ownership of real property. Ownership of land can be transferred consensually (by agreement) by:

- (1) sale, ie conveyance under Torrens title or old system/general law procedures (general procedures are outlined at ¶3-450);
- (2) gift, ie an assignment by deed (¶5-040) without consideration;
- (3) assignment by deed (¶5-040) with consideration (¶5-400);
- (4) a declaration of trust (¶9-830—¶9-840);
- (5) inheritance under a will (¶3-700ff).

These methods parallel those for the transfer of personal property: ¶3-460.

Furthermore, possession of land may be transferred by the creation of an easement (such as a right of way) or a lease. Other persons may acquire an interest in land under a mortgage as discussed at ¶13-040ff.

In addition, land can be transferred non-consensually (without agreement) by:

- bankruptcy, ie where the bankruptcy trustee acquires title to the property of the bankrupt (¶13-630);
- court settlement;
- execution of a court judgment (¶1-435);
- compulsory acquisition or resumption by a government authority;
- the administration of an intestate estate (no will: ¶3-730).

These methods also apply to the non-consensual transfer of personal property: ¶3-460.

¶3-450 A conveyance of real property: the general procedure. Conveyancing is the transferring of ownership of, or an interest in, real property from one person to another, and is normally carried out by a solicitor or conveyancer. Transferring ownership usually involves more than preparation of a contract and payment of the price, as there are many checks and searches to be undertaken to determine exactly what is being conveyed from the vendor to the purchaser. A conveyancer may also have to advise the client on other matters such as insurance and finance, and negotiate appropriate mortgage terms.

Generally, the conveyancing of a property involves four main stages:

- (1) *Preparation of the written contract.* The *Statute of Frauds 1677* (Imp) or equivalents require contracts for the sale of land to be evidenced in writing (¶5-030): “real estate is ordinarily agreed to be sold by the execution by the vendor and purchaser of a form of contract adopted by the Real Estate Institute of Queensland and approved by the Queensland Law Society”¹⁴ (or

14. *Marek v Australasian Conference Association Pty Ltd* [1994] 2 Qd R 521 at p 527.

equivalent in other jurisdictions). The written contract is generally prepared by the vendor or the vendor's solicitor, often on a standard form real estate industry printed contract. It is necessary to ensure that there is an adequate description in the contract of the subject matter of the sale including:

- title description
- dimensions and area
- survey certificate
- mortgages
- encumbrances (eg easements, covenants)
- reservations
- drainage
- encroachments
- chattels
- fixtures
- livestock
- vacant possession
- goodwill of a business
- condition of improvements

At this stage a holding deposit may be paid.

Consumer protection initiatives exist in some jurisdictions such as "cooling off" periods (which allow withdrawal from the contract after the signing of a contract to buy residential real estate).

(2) *Exchange or signing of contracts.* The contract is made in many jurisdictions such as New South Wales by exchange of signed duplicate contracts (prepared as in (1) above) and payment of the deposit (usually 10% of the purchase price). Exchange may take place by physical exchange, postal exchange, Document Exchange (DX) or telephone exchange.¹⁵ In other jurisdictions, the contract is generally concluded by each party signing both copies of the contract.

(3) *Searches and inquiries.* Before the final settlement of a conveyance, searches and inquiries are made by the purchaser or the purchaser's solicitor relating to the property and the title of the vendor. A search of the vendor's title is made at the relevant registry and, in many jurisdictions, the purchaser sends the vendor "requisitions on title" — a questionnaire which asks for details on the land. The purchaser or solicitor also sends inquiries to various statutory authorities such as the local council (regarding, for example, zoning and rates), the relevant water authority (regarding drainage diagram and rates), and the land tax department (regarding land tax payable). In some jurisdictions, such as New South Wales and Victoria,¹⁶ the vendor is required to provide purchasers with this title information and to warrant that the land is not affected by various government proposals unless set out in the contract. (Negligence and mistakes on the part of the relevant authority in responding to inquiries can lead to serious consequences in tort as illustrated in the *Parramatta Council case*, noted at ¶4-260.) The purchaser also prepares a transfer of title, pays stamp duty, forwards the transfer to the vendor for signing before settlement and finalises any mortgage details.

15. Exchange of contracts by telephone?: *Henderson v Hopkins* (1988) NSW ConvR ¶55-389, noted (1988) 62 ALJ 639.

16. *Conveyancing Act 1919* (NSW) sec 52A; *Conveyancing (Vendor Disclosure and Warranty) Regulation 1986* (NSW); *Sale of Land Act 1962* (Vic) sec 32.

The vendor answers the requisitions on title, signs the transfer and arranges for the vendor's mortgagee (if any) to come to the settlement to be paid out and to discharge the mortgage so as to give clear title to the purchaser.

(4) *Settlement*. At settlement, the balance of the purchase money is paid in exchange for the title and the keys to the property being handed over. Settlement generally takes place where the vendor's title deeds are located, such as at a bank or a solicitor's office which may be some distance from the property. Where there is a lender to the purchaser such as a bank or a building society, its representative usually attends with a bank cheque for the amount loaned on the security of the property. Apart from some post-settlement legalities, such as registration and forwarding notices of acquisition to various authorities, the conveyance is complete and the purchaser is able to move in.

¶3-460 Transfer of ownership of personal property.

Ownership of personal property can be acquired by creating or making the property, and by various methods of transfer of personal property which parallel the transfer of ownership of real property (¶3-440).

Consensual transfer of property or transfer of property by agreement

(1) *Purchase and sale*. Transfer of property under a contract of sale is the most common method of property transfer. Contracts in respect of personal property are regulated by the *Trade Practices Act 1974* and/or the sale of goods legislation (¶7-015).

(2) *Transfer or gift by delivery*. Ownership of personal property can also be transferred or gifted (without a contract of sale) by delivery, provided that there is:

- an intention to transfer title,
- delivery of the personal property, and
- acceptance of the delivery by the recipient (the donee).

Delivery may be actual (ie the handing over of the item itself) or it may be constructive (ie handing over the means to obtain the item such as handing over the keys to a safe deposit box).

— *Case example* —

A medical centre claimed that it was the proprietor of the paper on which its employee doctors made medical records and therefore that it was the owner of the medical records. The court held that as each piece of paper was completely transformed by the doctor writing on it, the ownership of the paper passed from the employer medical centre to the employee doctor during the doctor's employment. "From the [centre's] point of view the paper is used up and gone, as much as the services they supplied to the doctors".

— *Health Services for Men v d'Souza*¹⁷ —

17. [1999] NSWSC 969, per Bryson J at [41], noted (1999) 73 ALJ 875.

Mere words of gift may be insufficient to prove gift by delivery — delivery must actually take place, and there may be no constructive delivery if the item has remained in the possession of the supposed donor, especially if the donor and donee live together.

— *Case example* —

D wanted to give some bonds to his wife in case he died. He visited his bank with his wife, put the bonds into a sealed parcel with his wife's name on the outside and locked the parcel in his box at the bank with the intention that when his executors opened the box they would hand the parcel over to his wife. This gift was later held to be legally ineffective because there was no delivery of the key to D's wife at the time of the gift even though when they returned home D gave the key to his wife for safekeeping. The court confirmed that there must be actual or constructive delivery. The later delivery of the key did not pass ownership of the bonds, as it might with goods in a warehouse, because the bank would not open the safety deposit box without the authority of D.

In re Wasserberg; Union of London and
Smiths Bank Ltd v Wasserberg¹⁸ —

Donatio mortis causa. In the *Wasserberg case*, the imperfect delivery of the sealed parcel — which failed as a gift — was held to constitute a valid *donatio mortis causa* (a gift of property in anticipation of death). For a gift of personal property in anticipation of death to be legally effective, it must—

- be intended to take effect on the death of the donor as caused by the donor's existing illness, and
- be completed by delivery (or something amounting to delivery) to the donee at the time of death.

(3) *Transfer by deed of assignment.* The transfer of tangible and intangible personal property (¶3-040) is regulated by various laws dealing with the assignment of choses in action (¶13-340).

(4) *Transfer by declaration of trust* (¶9-830 — ¶9-840).

(5) *Inheritance under a will* (¶3-700), intestacy (ie “no will”: ¶3-705) or *transfer by declaration of a trust* (¶9-830).

(6) *Taking possession of abandoned property.* If there is evidence that the true owner intended to abandon ownership, a person may acquire ownership by taking possession of abandoned property. To come within this rule, a finder would have to prove that the goods were abandoned: ¶3-060.

Non-consensual transfer or transfer without agreement

Transfer of personal property by operation of law, which can result in non-consensual transfer of property, involves the same methods as the non-consensual transfer of real property, outlined above at ¶3-440.

18. [1915] 1 Ch 195 at p 202.

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¶3-470 Intellectual property. Intellectual property laws include:

- copyright (¶3-480—¶3-545),
- designs (¶3-550—¶3-570),
- patents (¶3-580—¶3-640), and
- trade marks (¶3-650—¶3-680).

Sales literature, software and promotional film about the product may be protected by copyright; its shape or pattern may be registered as a design; its invention may be patented; its name may be registered as a trade mark; and confidential information about it may be protected by action for breach of confidential information (¶3-685).

¶3-470

The intangible property assets which intellectual property laws protect may be the most valuable assets of a business.

Legal protection is given to intellectual property in the public interest to encourage creative intellectual effort. Protection is also given on the grounds of fairness to protect the property of creators. Legal protection is given to intellectual property through legislation and the common law:

- (1) principal legislation providing protection: the *Copyright Act 1968* (Cth) (¶3-480); the *Designs Act 1906* (Cth) (¶3-550); the *Patents Act 1990* (Cth) (¶3-580) and the *Trade Marks Act 1995* (Cth) (¶3-650).
- (2) the common law provides protection through the tort of passing off¹⁹ (¶12-030), and the protection of confidential information (¶3-685).

¶3-480 Copyright. The law of copyright in Australia is governed by the *Copyright Act 1968* (Cth). Copyright can subsist in two broad categories of material:

- (1) “works” (ie original literary, dramatic, musical or artistic works dealt with in Part III of the Act), and
- (2) subject matter other than works (ie sound recordings, cinematograph films, television and sound broadcasts and published editions of works dealt with in Part IV of the Act).

Although it is expressed in the singular, copyright is in effect a “bundle of rights”.²⁰ Copyright confers upon the owner the exclusive right to do, or to authorise others to do, the acts listed by the *Copyright Act* in relation to each type of subject matter.

Copyright arises by bringing a work into existence, and there is no requirement of registration of either creator or work. The copyright symbol “©” is used to indicate copyright and as a reminder that copyright subsists, but it is not necessary for the ownership of copyright nor does it confer copyright.

¶3-490 How copyright arises. The *Copyright Act 1968* (Cth) divides the works which are the subject of copyright into two categories, published works and unpublished works.

Published works. Copyright over published works (Part III copyright: ¶3-500) arises if:

- the work was first “published” or “made” in Australia. Copyright subsists in the expression of an idea and not the idea itself.

19. Since 1974 a trader has been able to obtain protection against the activities of a corporate competitor under Pt V of the *Trade Practices Act* as an alternative to passing off.

20. per Windeyer J in *Pacific Film Laboratories Pty Ltd v FC of T* (1970) 121 CLR 154.

— *Case examples* —

“My Racing Secrets. By Steve Donoghue”. A journalist interviewed a famous jockey and published the interviews in the newspaper. Five years later, the journalist wrote articles based on the interviews and planned to publish them in another newspaper. The jockey was not able to restrain publication on the ground that he was the author. “[T]here is no copyright in an idea, or in ideas.” Copyright vests in the journalist, author, etc who turns the original idea into a published work.

*Donoghue v Allied Newspapers Ltd*²¹ —

“Jaws”. The owners of the film “Jaws” successfully sued the producers of an Italian film called “Great White” for infringing copyright in their novel, screenplay and film: “In general, there is no copyright in the central idea or theme of a story or play, however original it may be; copyright subsists in the combination of situations, events, and scenes which constitute the particular working out or expression of the idea or theme. If these are totally different the taking of the idea or theme does not constitute an infringement of copyright.”

*Zeccola v Universal City Studios Inc*²² —

- the work is original: sec 32(1).
- the author is “qualified” — the definition of “qualified” includes an Australian citizen or living in Australia at the time of first publication: sec 32(2).

Unpublished works. Copyright over unpublished works (ie Part IV copyright: ¶3-530) arises under sec 32 if:

- the author is a “qualified person” (sec 32(1)(a).
- where the making of the work extended over a period, the author was a qualified person for a substantial part of that period (sec 32(1)(b)).

¶3-500 Copyright in original works: Part III. Part III of the *Copyright Act 1968* (Cth) regulates copyright in literary, dramatic, musical and artistic works. Section 31(1) of the Act provides that copyright in relation to a “work” is the exclusive right:

- “(a) in the case of a literary, dramatic or musical work, to do all or any of the following acts:
- (i) to reproduce the work in a material form;
 - (ii) to publish the work;
 - (iii) to perform the work in public;
 - (iv) to broadcast the work;
 - (v) to cause the work to be transmitted to subscribers to a diffusion service;
 - (vi) to make an adaptation of the work;
 - (vii) to do, in relation to a work that is an adaptation of the first-mentioned

21. [1938] 1 Ch 106 at p 109.

22. (1982) 46 ALR 189 at p 192.

work, any of the acts specified in relation to the first-mentioned work in subparagraphs (i) to (v), inclusive; and

(b) in the case of an artistic work, to do all or any of the following acts:

- (i) to reproduce the work in a material form;
- (ii) to publish the work;
- (iii) to include the work in a television broadcast;
- (iv) to cause a television programme that includes the work to be transmitted to subscribers to a diffusion service; and

(c) in the case of a literary work (other than a computer program) or a musical or dramatic work, to enter into a commercial rental arrangement in respect of the work reproduced in a sound recording; and

(d) in the case of a computer program, to enter into a commercial rental arrangement in respect of the program.”

Literary works. Section 10 of the Act defines the words “literary work” to include:

“(a) a table, or compilation, expressed in words, figures or symbols (whether or not in a visible form); and

(b) a computer program or compilation of computer programs”.

Generally, copyright cannot subsist in the title of a work or a name.

— Case example —

Classified advertisements. When the Daily Telegraph reproduced a literal transcription of The Sydney Morning Herald’s births and deaths announcements, the Herald obtained an injunction to restrain further publication. The Daily Telegraph then published a re-arrangement of the information in the Herald’s announcements and this was held not to infringe the Herald’s copyright. Copyright in the text of the announcement belonged to the advertiser, and copyright in the columns as arranged and published belonged to the newspaper. A newspaper does not, however, have an exclusive right to the dissemination of news or events published in it.

— *John Fairfax & Sons Pty Ltd v Australian Consolidated Press Ltd*²³ —

Dramatic works. Dramatic works are defined in sec 10 to include:

“(a) a choreographic show or other dumb show; and

(b) a scenario or script for a cinematograph film,

but does not include a cinematograph film as distinct from the scenario or script for a cinematograph film”.

Film. Video images generated in a computer game constitute a “cinematograph film” and are subject to copyright protection under Part IV.²⁴

23. (1960) 60 SR(NSW) 413.

24. *Galaxy Electronics Pty Ltd v Sega Enterprises Ltd* (1997) AIPC ¶91-321; (1997) 37 IPR 462.

Artistic works. Section 10 defines artistic works as meaning a painting, sculpture, drawing, photograph, engraving, building or model of a building, or a work of artistic craftsmanship. A circuit layout within the meaning of the *Circuit Layouts Act 1989* (Cth) (¶3-505) is not included as an artistic work.

Musical work. The words “musical work” have their ordinary meaning.

Sound recording and sound-tracks. A sound recording is defined by sec 10 to be “the aggregate of the sounds embodied in a record.” A “sound track”, in relation to a film is defined as meaning:

- “(a) the part of any article or thing, being an article or thing in which those visual images are embodied, in which sounds are embodied; or
- (b) a disc, tape or other device in which sounds are embodied and which is made available by the maker of the film for use in conjunction with the article or thing in which those visual images are embodied.”

Section 23 provides that “sounds embodied in a sound-track associated with visual images forming part of cinematograph films shall be deemed not to be a sound recording”.

— *Case example* —

A majority of the High Court has found that the broadcast of a film broadcasts not only the soundtrack of the film but the sound recordings embodied in the soundtrack. The soundtrack itself is not a sound recording but may contain sound recordings.

— *Phonographic Performance Company of Australia Ltd v Federation of Australian Commercial Television Stations*²⁵ —

Protection of performers and their performance. Unauthorised use (defined in sec 248G) of a performance is also prohibited.

¶3-505 Copyright in computer programs. Copyright protection of literary works under sec 36 (¶3-520) was extended in 1984 by amendment of the definition of “literary work” to include a computer program:²⁶

“‘computer program’ means an expression, in any language, code or notation, of a set of instructions (whether with or without related information) intended, either directly or after either or both of the following:

- (a) conversion to another language, code or notation;
- (b) reproduction in a different material form,

to cause a device having digital information processing capabilities to perform a particular function”.

This amendment was added to protect copyright in computer programs after the decision in the *Computer Edge case*:

25. (1998) AIPC ¶91-416; (1998) 72 ALJR 924. 26. *Copyright Act 1968* (Cth) sec 10(1).

— *Case examples* —

Under the law as it stood before the 1984 amendment, Apple failed to restrain a company from importing Wombat computers which operated using Apple II programs. Apple claimed that the company had copied the Apple programs in the source code and the object code and had infringed Apple's copyright in the programs. The High Court upheld copyright protection for Apple's source code programs as original "literary works", but denied copyright protection as "literary works" to its object code programs in the form in which they were written. These were the same programs in object code, a sequence of electrical impulses stored in ROM (a read only memory chip). The object code did not qualify as "literary works" as it was not expressed in writing or print and could not be represented in writing or print: it consisted of electrical impulses produced by computer, stored in the chip and invisible to the naked eye.

*Computer Edge Pty Ltd v Apple Computer Inc*²⁷ —

The High Court has confirmed copyright protection for a hardware lock or autokey required to be fitted to the computer to make a computer-aided drafting program work. By using an oscilloscope, an engineer was able to observe the workings of the lock, and develop his own device which performed the same function as the lock.

In a unanimous decision the High Court gave copyright protection to the lock as a "computer program". The court confirmed that the expression "computer program" includes "the stored set of instructions in a non-sensate form such as electrical impulses". The copyright test of originality was therefore "satisfied by the originality of the set of instructions" and any unauthorised expression of it in language, code or notation was held to infringe the copyright in the computer program.

*Autodesk Inc v Dyason*²⁸ —

The High Court added to its earlier comments on copyright protection of software and data in *Autodesk (No 2)*. It confirmed that the definition of a "computer program" should be understood as protecting the set of instructions itself. Copyright protects not the idea but the form of expression.

*Autodesk Inc v Dyason (No 2)*²⁹ —

PFXplus. P, the owner of a computer program called Dataflex first published in 1981, sued D for infringement of its copyright. D created a program called PFXplus by reverse engineering of Dataflex. The High Court held that:

- although PFXplus had 192 words in common with Dataflex (the Reserved Words), these were neither a "computer program" within sec 10 nor a "literary work".
- the macros had not been reproduced or adapted. The underlying source code of a macro can amount to a computer program, but there was no copying of the source code.

27. (1986) 161 CLR 171, (1986) 60 ALJR 313; eg McKeough, J (1984) 7 UNSWLJ 161; ¶7-280.

28. (1992) 173 CLR 330 at p 335.

29. (1993) 67 ALJR 270. Final round: *Autodesk Australia Pty Ltd v Dyason* (1995) AIPC ¶91-157.

- as D had reproduced the Dataflex Huffman table embedded in the Dataflex program, a table expressed in figures and symbols which qualifies as a “literary work” (sec 10), D did infringe P’s copyright in the Huffman table.

————— *Data Access Corporation v Powerflex Services Pty Ltd*³⁰ ———

Protection (minimum 10 years, maximum 20 years) is provided by the *Circuit Layouts Act 1989* (Cth) to protect computer chip layouts from unfair copying by granting the creator the exclusive rights (“eligible layout” or EL rights) to copy the layout, directly or indirectly, in a material form, to make an integrated circuit in accordance with the layout, and to exploit the layout commercially in Australia (sec 17). Like copyright, the creator’s rights, enforceable by a civil claim for damages, arise automatically with no registration (as under the *Designs Act 1906* (Cth)) (sec 27).³¹

¶3-510 Ownership and duration of copyright in original works. Generally the author of a work is the first owner of the copyright.

Employment. Where a literary, dramatic, artistic or musical work is made by an author pursuant to the terms of the author’s employment, and under a contract of service or apprenticeship, the employer is the owner of the copyright: sec 35(6). In contrast, copyright in works created by an independent contractor under a contract of services (¶11-020), such as a freelance, remains vested in the author.

Educational copyright. Staff members of educational institutions and students retain ownership of copyright in a copyright work of which they are the author if the subject matter is mainly concerned with scholarship, research, artistic expression, creativity or academic debate — except, for example:

- course materials;
- a work which is based on intellectual property owned by the educational institution.

Students always retain the ownership of theses, reports and publications.

Journalists’ copyright. If a literary, dramatic or artistic work is made by a journalist for inclusion in the newspaper, magazine or periodical for which the journalist works, copyright only belongs to the journalist for the purposes of publication in a book, or reproduction in the form of a hard copy or facsimile made from a paper edition of an issue of the newspaper, magazine or periodical. Otherwise, copyright vests in the owner of the newspaper, magazine or periodical (sec 35(4)).

30. (1999) 73 ALJR 1435, [1999] HCA 49, noted (1999) 12(4) IPLB 40.

succeeded in infringement action under the *Circuit Layouts Act 1989* (Cth)).

31. eg *Nintendo Co Ltd v Centronics Systems Pty Ltd* (1994) 68 ALJR 537 (Nintendo

— Case example —

A photographer took a photo of Kate Fischer for an article about her in *Cleo* magazine, owned by Australan Consolidated Press (ACP). Without the consent of the photographer or the payment of a fee to him, ACP supplied the photo to another publisher, which sold it to the publisher of *New Idea*, where it appeared on the cover in 1997. The court awarded the photographer damages for breach of his statutory right of restraint under sec 35(5), based upon the “lost chance” to negotiate, which it calculated at \$1,500 plus interest.

*Matthews v ACP Publishing Pty Ltd*³² —

Photos. Copyright in a photo commissioned for “private and domestic purposes”, defined to include “a portrait of family members, a wedding party or children”, vests in the commissioning party.³³ For example, suppose a woman takes photos of her friend frolicking topless at the beach. Five years later, the topless woman becomes world famous and the friend publishes the old photos. Unless the topless woman “commissioned” the photos, copyright remains with the photographer who would be free to use them.³⁴

Duration of copyright. Generally copyright exists for 50 years after the death of the author and after this the work can be freely used without permission as it is then in the “public domain”:

- In the case of literary, dramatic, musical or artistic works (other than photographs), copyright exists for the life of the author or artist plus 50 years from their death, or in the case of a work not published in the author or artist’s lifetime, for 50 years from publication or first performance.
- In the case of joint authorship, copyright exists for the life of the authors plus 50 years from the death of the last surviving author.
- In the case of a photograph, copyright exists for 50 years from first publication.³⁵
- In the case of a sound recording, film, TV or sound broadcast, copyright exists for 50 years from first publication or broadcast.
- A performer has protection against certain types of use of unauthorised recordings of the performance for either 20 or 50 years, depending upon the type of use and the date of the use: Part XIA, ¶3-530.

32. (1998) 157 ALR 564, noted Theedar, S, *Ownership of copyright in commissioned photographs* (1998) 11(5) IPLB 49. Amendments to sec 35 in 1998 do not affect this decision, as the author’s right of restraint continues to apply in respect of photographs commissioned for “private or domestic purposes” (sec 35(7)).

33. *Copyright Amendment Act (No 1) 1998* (Cth) sec 35.

34. Example taken from Theedar, S, *Privacy in photographic images* (1999) 12(5) IPLB 45.

35. If the photo was taken before May 1989, copyright exists from the date the photo was taken.

¶3-520 **Infringement of copyright in original works.** The rights attached to copyright in literary, dramatic, musical or artistic work (as defined in sec 31: ¶3-500) are infringed “by a person ... not being the owner of the copyright, and without the licence or consent of the owner of the copyright” (sec 36(1)) doing any act comprised in the copyright. The acts comprising the copyright in literary, dramatic, musical and artistic works are outlined in sec 31 of the *Copyright Act 1968*. Copying or substantial reproduction in any material form of a copyright work, including sampling,³⁶ is therefore an infringement. In the case where a person independently produces a work the same as a copyright work, the person will not have infringed the copyright.

Infringement of literary, dramatic, musical and artistic works is extended to cover importing copies for sale, hire, distribution or exhibition without the owner’s consent where the importer has knowledge that to have made the copies in Australia would have been an infringement of copyright (sec 37), and selling, hiring, exposing for sale or distributing without consent (sec 38). This is contrasted with parallel importation which deals with non-infringing copies.

— *Case example* —

Aboriginal paintings, which had been exhibited nationally and which appeared in Australian National Gallery publications, were reproduced, without the consent of the artists, on carpets made in Vietnam. Importing the carpets into Australia for sale was held to breach sec 37 and damages were awarded against the importer.

— *Milpurrruru v Indofurn Pty Ltd*³⁷ —

Performing a copyright work in public (except an artistic work) and broadcasting the work or including it in a television broadcast also infringes copyright (sec 31). For the purposes of sec 31 (and sec 86(b)), the performance must be “in public”. This does not necessarily refer to a public audience or the general public, as “a performance will be ‘in public’ if it is not ‘in private’” ie those attending are not bound together by a domestic or private tie.³⁸

Performers (actors, etc) have unassignable civil rights (with counterpart criminal offences) over their live performances, set out in Part XIA (in force 1989).

Parallel imports. The *Copyright Act* formerly permitted the Australian copyright owner of artistic works in packaging or labelling to restrict the import and distribution of packaged or labelled goods on the basis of copyright infringement.

36. “Sampling” in the music industry refers to using sounds from an earlier recording: *Two aspects of sampling in the music industry* (1989) 63 ALJ 771; Letter to the Editor (1990) 64 ALJ 228.

37. (1995) AIPC ¶91-116.

38. *Australasian Performing Right Association Ltd v Commonwealth Bank of Australia* (1992) 40 FCR 59, per Gummow J at p 74.

— *Case example* —

Under the old law, the overseas manufacturer of “Bailey’s Original Irish Cream” whiskey was able to prevent the parallel import into Australia of genuine bottles of the product by an unauthorised Australian importer by relying on ownership of the copyright of the labels on the bottles.

*RA & A Bailey & Co Ltd v Boccaccio Pty Ltd*³⁹ —

The *Copyright Act* was amended in 1998⁴⁰ so that the packaging and labelling⁴¹ can now be imported without the permission of the Australian copyright owner so long as the packaging or labelling was authorised by the copyright owner in the country of origin.

Sound recordings. Until amendment in 1998, Australian copyright owners were able to limit competition by preventing the import of “genuine” recordings. These restrictions on the parallel import of legitimate copies of sound recordings were removed in 1998,⁴² so that legitimate (ie non-pirate) sound recordings can now be imported without the consent of the local copyright owner. In case the amendments result in a flood of “pirate” imports, the amendments increased the penalties for copyright piracy offences, including reversing the onus of proof on an importer or distributor to show that an imported recording is not a “pirate” copy.

Actions not infringing copyright. There are a number of acts that do not constitute an infringement of copyright. These are:

- fair dealing for the purpose of: research and study (sec 40), criticism or review (sec 41), and reporting news (sec 42). However, “fair dealing” would not cover a reviewer quoting the whole of a poem, a student photocopying the whole of a textbook, or the playing of a musical work during the news if it does not form part of the news being reported;
- making a backup copy of a computer program (sec 43A);⁴³
- inclusion of works in collections for use by places of education (sec 44);
- importing legitimate copies of books into Australia. Under sec 44A, added in 1991, owners of copyright in overseas books may lose the right to control imports; and unrestricted commercial imports of “non-pirate”

39. (1986) 6 IPR 279. Other remedies were and remain those under the *Trade Practices Act 1974* (Cth) sec 52, 53(c), 53(d), 53(ea) or 53(g) (¶7-250ff). In the *Milpurrrru* case, the carpets were also held to infringe *TPA* sec 52, 53(c) and 53(d) for the false and misleading statements contained in the tag attached to each carpet (eg that royalties were paid to the artist).

40. *Copyright Amendment Act (No 1) 1998* (Cth) and *Copyright Amendment Act (No 2) 1998* (Cth).

41. ie a “non-infringing accessory”: sec 44C.

42. *Copyright Amendment Act (No 2) 1998* (Cth).

43. The *Copyright Amendment (Computer Programs) Act 1999* (Cth), which commenced on 30 September 1999, now permits certain conduct which might otherwise infringe copyright in computer programs such as copying for normal use or study, making backup copies and correcting errors.

copies of new books (other than those first published in Australia) are permitted if:

- under the 30 day rule, the book is first published overseas and is not published in Australia within 30 days, or
 - under the 7/90 day rule, the owner does not advise within seven days whether it can supply the book, and that it can fill the order within 90 days, or the owner does not fill an order within 90 days, or
 - an order is placed for a single copy for non-commercial purposes, or for multiple copies for a non-profit library (sec 44A, inserted 1991).
- performances at home (sec 46), copying works in libraries for users (sec 49 and 51A), reproduction of sculptures or works of artistic craftsmanship situated in a public place (sec 65), depictions of buildings and models of buildings (sec 66) and the incidental inclusion of artistic works appearing in film or television broadcasts (sec 67-70);
 - educational photocopying under a statutory licence: Part VB. Educational institutions can make multiple copies of insubstantial portions of copyright material on their premises for the purposes of their educational courses (sec 135ZG). An insubstantial portion is limited to two pages or 1% of the work (if it is not more than 200 pages), whichever is the greater, so long as the work copied is not the whole work (such as a poem: sec 135ZG(3)). Musical works, artistic works, computer programs and compilations of computer programs cannot be copied under sec 135ZG.

Under a statutory licence, educational institutions can make multiple copies of:

- the whole or part of an article in a periodical, but not more than one article in the same periodical can be copied unless they relate to the same subject matter (sec 135ZJ);
- the whole or part of a literary or dramatic work which is contained in not more than 15 pages in a published anthology of works (sec 135ZK);
- the whole or part of a literary, dramatic, musical or artistic work that has not been separately published (sec 135ZL(1));
- a “reasonable portion” of any one work (ie no more than 10%, or one chapter, whichever is the greater) (sec 10(2)). More than a “reasonable portion” can be copied of new copies if they cannot be obtained within a reasonable time at an ordinary commercial price (sec 135ZL(2)). Illustrations may be included.

Out of print artistic, dramatic, literary or musical works may be copied in full if the work is not available for purchase at an ordinary commercial price from the educational institution’s normal supplier within six months (for text books) or 90 days (for other works).

Educational photocopying is administered under agreements between the Copyright Agency Ltd (CAL — the authors' and publishers' collecting society) and the educational institutions.

— *Case examples* —

Part VB gives a conditional exemption from infringement of copyright in respect of “the copyright in an article contained in a periodical publication” (sec 135ZJ(1)). Lecturers in the Psychology Department in the Faculty of Arts at Victoria University of Technology (St Albans campus) made collections of readings which were printed in the faculty's print room and sold through the university's bookshop (on a mark-up of 30% over direct photocopying expenses to cover production and distribution costs). The Copyright Agency Ltd failed in a claim that because sec 135ZL is not intended to authorise multiple copies in the course of the business of quasi-publishing or book selling, the copies fell outside the statutory licence and that Victoria University was therefore in breach of copyright. The copies were produced and distributed to issue to students at minimum cost, were specific to the Victoria University course and did not involve sales with the object or purpose of returning a profit.

To determine whether the activities complained about were within the statutory licensing provisions, the court held that the correct approach was to apply a purposive test. Applying a purposive test, the court found that Victoria University was not engaged in any business of quasi-publishing or bookselling. Its activities were held to be consistent with the policy underlying the educational photocopying provisions of the *Copyright Act*.

The case therefore establishes that it is legitimate for educational institutions to provide their enrolled students with collections of readings containing copies of articles, none of which exceeds the statutory limits, and for the educational institutions to recover the costs involved from the students.

————— *Copyright Agency Ltd v Victoria University of Technology* ⁴⁴ —

Publishers mainly of Australian newspapers or magazines failed in an application for a share of fees collected by the Copyright Agency Ltd from educational institutions under Part VB. The articles copied were not substantial parts of the relevant works and the court held that published edition copyright is not infringed by reproduction of a single item in an edition unless that item is so significant that it constitutes a substantial part of the work.

————— *Nationwide News Pty Ltd v Copyright Agency Ltd* ⁴⁵ —

The *Copyright Act 1968* (Cth) also provides for the following educational photocopying:

- the inclusion of short extracts in a collection of works intended for educational use (sec 44);
- copying by libraries and archives for users for research or study (sec 49);
- copying for inter-library loans or archives loans (sec 50);

44. (1994) AIPC ¶91-104; (1995) AIPC ¶91-118.

45. (1995) AIPC ¶91-117; (1995) 30 IPR 140; noted (1995) 69 ALJ 328.

- copying of old (over 50 years) unpublished works and theses (sec 51);
 - copying for preservation and replacement (sec 51A, 51AA);
 - copying works and broadcasts for educational purposes (sec 200); and
 - statutory licence for copying for defined purposes by institutions assisting the disabled and by federal/State/Territory governments (sec 135ZN—135ZQ).
- educational institutions pay an annual per capita copyright fee based on student numbers to the Audio Visual Copyright Society Ltd to allow copying rights in respect of radio and TV broadcasts to be used in university classes under Part VA of the *Copyright Act*. This does not authorise the recording without permission of pre-recorded material such as hired videos.

¶3-525 Authors' moral rights: Part IX. Amendments to the *Copyright Act* are proposed to provide for moral rights for creators of copyright works and films by the recognition or attribution of their authorship.⁴⁶ Under proposed new Part IX, copyright creators would have the right:

- To be identified as the author of the work — the right of attribution or authorship. For example, a graphic artist would have the right to attribution on a corporate brochure using the artist's work.
- To take action against false attribution — the right not to have authorship of a work falsely attributed.
- To object to derogatory treatment of their work which prejudicially affects their honour or reputation — the right of integrity of authorship. For example, a poet can object to a publisher changing the poem.

Hence authors of literary, dramatic, musical and artistic works and films — not sound recordings — will be able to insist on having their names identified with their work or film even if the creator has licensed or assigned away the copyright in the work.

Part IX will provide a checklist to help establish "reasonableness" in determining derogatory treatment or non-attribution.

¶3-530 Copyright in sound, film, broadcast and published editions of works (Part IV) and performers' protection (Part XIA). Part IV of the *Copyright Act 1968* (Cth) protects copyright in subject matter other than original works, such as sound recordings (sec 85), films (sec 86), television and sound broadcasts (sec 87) and published editions of works (sec 88, 92, 100). The copyright subsists for 50 years after first

46. *Copyright Amendment (Moral Rights) Bill 1999* (Cth), noted, eg, *Moral rights*

bill on the table (1999) 12(6) IPLB 59; Ellinson, D, *New rights proposed for copyright creators* (2000) 74(2) LIJ 68.

publication (25 years after first publication in the case of a published edition of a work) and is in addition to and independent of any copyright already subsisting (sec 113(1)). Part IV copyright vests in the maker of the sound recording (sec 97) or film (sec 98) unless made under contract for another person.

— *Case example* —

“Free in-house movies”. Showing free in-house movies in motel rooms without a licence from the copyright owner was held to be an infringement of copyright in breach of sec 86(b). Although shown in private, the movies were part of a commercial transaction because they were shown to guests of the motel, who were a section of the public.

— *Rank Film Production Ltd v Colin S Dodds*⁴⁷ —

Infringement of Part IV copyright occurs when a person — not the owner, and without the licence of the owner — does or authorises the doing of any act comprised in the copyright (sec 101). Copyright is also infringed by importing into Australia and then selling, hiring, exhibiting or distributing an article which, if it had been made in Australia, would have constituted a breach of copyright (sec 102, 103) so long as knowledge of the breach of copyright can be proved.

Performers’ protection. Part XIA of the *Copyright Act* (sec 248A–248V) enables performers to take civil action against anyone making “unauthorised use” of their performance. Unauthorised use includes making and/or broadcasting an authorised performance. Performers are protected for 20 years for a performance (sec 248CA(1)).

Acts not infringing copyright. The non-commercial use of sound, film, etc does not infringe copyright in the following circumstances: the use of a recording in class by a teacher in the course of educational instruction (sec 28); use for the purposes of judicial proceedings (sec 104(a)); use by a legal practitioner or patent attorney in giving advice (sec 104(b)); use in a guest house or club (sec 106); use if “equitable remuneration” has been paid (sec 108); and use for private or domestic purposes (sec 111).

¶3-540 Remedies for copyright infringement. In line with the purpose of copyright protection, remedies are available to the copyright owner (under Part III and Part IV) for unauthorised use of a copyright work.

Statutory remedies. The *Copyright Act* provides for action for infringement of copyright within six years by means of:

- an injunction to restrain infringement or threatened infringement of copyright (sec 115(2)). An interlocutory injunction⁴⁸ may be granted before trial, if there is a serious question to be tried and on the balance of convenience;⁴⁹ a final injunction may be granted if the infringement is likely to continue.

47. [1983] 2 NSWLR 553.

48. A provisional injunction: compare ¶6-410, ¶8-820.

49. Weighing the disadvantage of taking action against the disadvantage of not taking action.

- damages to compensate the plaintiff for loss suffered as a result of breach of copyright by the defendant (sec 115(2)). The court may make an order for damages or an account of profits but not both (sec 115(2)).
- account for profits (sec 115(2)). This is an equitable remedy under which the plaintiff may claim an amount which represents the share of the defendant's profits which resulted from infringement of the plaintiff's copyright.
- additional damages to reflect such matters as the "flagrancy" of the infringement (sec 115(4)).⁵⁰ This is the power to award exemplary, aggravated or punitive damages.
- damages and/or delivery of infringing copies to the owner as a remedy for the tort of conversion or detinue (¶4-020) under sec 116(1) on the basis that the copyright owner is deemed to be owner of the "infringing copy" (as defined in sec 10).
- summary offences. The *Copyright Act* provides that making infringing copies and other actions infringing copyright are summary offences with a fine of up to \$250,000 for a company or even imprisonment (sec 132, 133).

— *Case example* —

D bought about 2,000 computer disks from a private seller, many of which contained computer programs, and advertised them for sale in the "Weekly Trading Post" as "Apple" compatible computer software disks. He was convicted under sec 132 and 133A for advertising for sale a copy of a computer program when he knew or ought reasonably to have known it to be an infringing copy, and was fined \$750 for each of six offences and ordered to pay witnesses' expenses of some \$5,000.

— *Olsen v Hutchison*⁵¹ —

Penalties may be imposed under sec 203A-203H for breaches of the educational photocopying provisions (¶3-520) for unauthorised multiple copying by libraries and educational institutions.

General law remedies. In addition to the remedies for infringement under the *Copyright Act*, there are remedies at common law for infringement of copyright such as:

- the Mareva order — a court order to prevent assets from being moved from the jurisdiction or disposed of (¶6-415); and
- an Anton Piller order — a court order to enter premises and to inspect documents (¶6-416).

Trade Practices Act 1974 (Cth). In addition, it may be possible to bring an action under sec 52 of the *Trade Practices Act 1974* (Cth), and indeed many breach of copyright cases — such as the *Crocodile Dundee cases* — have been litigated under sec 52 (¶7-280).

50. *Raben Footwear Pty Ltd v PolyGram Records Inc* (1997) AIPC ¶90-928.
 51. (1992) AIPC ¶90-928.
 Records Inc (1997) AIPL ¶91-324.

¶3-545 Copyright: future directions. Rapid developments in information technology continue and will continue to test the outer limits of copyright law. In response to the challenges of the new technology, the *Copyright Amendment (Digital Agenda) Act 2000*⁵² aims to ensure that copyright owners will be able to commercially exploit their works in the emerging electronic markets and that users will be able to obtain reasonable access to copyright material in digital form. In particular, the Act aims to promote greater legal certainty in the digital environment for both owners and users of copyright material by:

- introducing a technology-neutral right of communication to the public to replace the existing broadcasting right;
- extending the existing fair dealing exceptions to a new right of communication to the public;
- extending the existing statutory licences of educational institutions to reproduction and communication of copyright material in electronic form;
- limiting the liability of carriers and Internet Service Providers (ISPs), and
- providing for a statutory licence scheme for the payment of equitable remuneration to underlying rights holders whose works are used in retransmitted broadcasts.

¶3-550 Designs. A design may qualify for legal protection under the *Designs Act 1906*.

A design may also be protected as an artistic work under the *Copyright Act 1968*.

Section 77 of the *Copyright Act* deals with the situation where a design has not been registered under the *Designs Act* or is not able to be registered under the Act. Section 77(1) provides that copyright in an artistic work is not infringed where:

- “(a) copyright subsists in an artistic work (other than a building or a model of a building, or work of artistic craftsmanship) ...;
- (b) a corresponding design is applied industrially ... by or with the licence of the owner of the copyright ...;
- (c) ... articles to which the corresponding design has been so applied ... are sold, let for hire or offered or exposed for sale or hire ...; and
- (d) ... the corresponding design is not registrable under the *Designs Act 1906* or has not been registered under that Act.”

Section 77(2) provides that it is not an infringement of copyright in the artistic work to apply the design industrially to an article.

52. Assented to on 4 September 2000 and to commence within six months and one day after assent. The Attorney-General has described the legislation as providing

the most significant and comprehensive set of reforms to Australian copyright law since the *Copyright Act* was passed in 1968.

The *Designs Regulations 1982* (Cth) exclude from registration under the *Designs Act* the following articles which are primarily literary or artistic in character: book jackets; calendars; certificates, forms or other documents; dressmaking patterns; greeting cards; labels; leaflets; maps; plans; postcards; stamps; transfers; and designs for medals (reg 11). This means that copyright as an artistic work is protected under the *Copyright Act* even though the articles are of industrial application.

A design can be protected by registration under the *Designs Act 1906* (Cth) if it falls within the following definition as set out in sec 4:

“‘design’ means features of shape, configuration, pattern or ornamentation applicable to an article, being features that, in the finished article, can be judged by the eye, but does not include a method or principle of construction”.

Design law protects the visual form of the article such as the design of a knife, a kitchen container or a chair. Four essential elements are necessary for the registration of a “design” under the *Designs Act 1906* (sec 4):⁵³

- There must be features of shape, configuration, pattern or ornamentation (such as the pattern of wallpaper or carpet, or the shape in which a vase or jug is made).
- These features must be “applicable” to an “article” of manufacture. Without the design, the article still retains its essential character as, say, a spoon or a chair. “Article” is defined in sec 4 to mean “any article of manufacture and includes a part of such an article if made separately”, ie basically man-made items, whether made by hand or machine, and whether durable or consumed.
- The features of the article must be capable of being “judged by the eye” in the finished article.
- The design must “not include a method or principle of construction” so as to overlap the patent system.

Proposed update of designs law. The Commonwealth government previously announced that the *Designs Act*, passed in 1906, was to be modernised and simplified to provide a more cost-effective system to encourage innovation in the design of manufactured products. The Australian Law Reform Commission has carried out a major review of designs law. An Issues Paper was published in 1993, a Discussion Paper in 1994 and a Final Report in 1995.⁵⁴

¶3-560 Registration of designs. Protection under the *Designs Act 1906* (Cth) is achieved by the registration of the design in the Register of Designs. The owner of a design may obtain registration by application with “representations” (such as drawings, specimens, etc) and, if requested, a

53. eg Ricketson, *op cit*, Ch 7. The Australian Law Reform Commission has recommended modernisation and simplification of the *Designs Act* in its report *Designs*, Report No 74, 1995, noted eg *Supporting innovation* (1995) 68

Reform 55; Gleeson, P, *Design rules for the '90s* (1996) 69 LIJ 1131.

54. Australian Law Reform Commission, *Designs*, ALRC 74, 1995; ALRC, *Industrial designs review* (1999) 73(5) LIJ 28.

“statement of novelty” (identifying features for which “novelty or originality” is claimed: sec 4). Further, the Registrar may request a “statement of monopoly” as defined in sec 4 (indicating features over which the applicant seeks monopoly: sec 20). To be registered under the *Designs Act 1906* (Cth), a design must be “new or original” (sec 17(1)) and, in particular, it will not be registered if it “differs only in immaterial details or in features commonly used in the relevant trade” (sec 17(1)(a)) or if it is “an obvious adaptation” of an already registered design (sec 17(1)(b)).

Registration of a design gives the owner a monopoly in that design (sec 25), meaning “the exclusive right to apply the design to an article in respect of which the design is so registered” (sec 4(1)).

Registration of a design lasts for one year and can be extended for up to 16 years, calculated from the date of application (the “priority date”). It can be extended for six years after the priority date, with the possibility of two further five-year extensions. After this 16-year period, anyone can use the design.

¶3-570 Infringement of designs. Monopoly rights in a registered design are protected by law, and infringement occurs where a person without the owner’s licence or authority:

- (a) imitates the design;
- (b) imports for sale or use in Australia any article in respect of which the design is registered; or
- (c) sells, hires, etc any article imitating the design (sec 30(1)(a)-(c)).

Remedies for infringement of monopoly in a registered design include an injunction (¶6-410) to restrain the infringement and, at the option of the plaintiff, either damages (¶6-420) or an account of profits (sec 32B). Where an infringer is able to show that the Register had been searched to determine the existence of the registration, the defences in sec 32B are available: that the infringement was innocent, or that all reasonable steps had been taken to determine its existence.

¶3-580 Patents. New inventions can be patented for legal protection by their owners. By disclosing the invention by lodging a specification⁵⁵ at the Patent Office, an inventor, if granted a patent, acquires the exclusive right to exploit the invention (sec 13).⁵⁶

A patent is a temporary monopoly given by the Crown under which the patentee gets the exclusive use of and the right to sell its new invention in return for the publication of the patent specification.

55. This contains drawings, etc to “fully describe the invention” and defines its scope: *Patents Act 1990* (Cth) sec 40(2). Specifications are usually drafted by registered “patent attorneys”.

56. The protection of patents goes back to the original *Statute of Monopolies* passed

in 1623 designed to limit the prerogative of the Crown to grant monopolies: *An act concerning monopolies and dispensations with penal laws and the forfeitures thereof*, 21 Jac 1, c 3. Modern patent law is built upon the Act’s exceptions in sec 6.

The rights given by a patent are set out in sec 13 of the *Patents Act 1990* (Cth) in the following words:

“13(1) Subject to this Act, a patent gives the patentee the exclusive rights, during the term of the patent, to exploit the invention and to authorise another person to exploit the invention.

13(2) The exclusive rights are personal property and are capable of assignment and of devolution by law.

13(3) A patent has effect throughout the patent area.”

The Dictionary contained in Sch 1 of the Act defines “exploit”, in relation to an invention, to include:

“(a) where the invention is a product — make, hire, sell or otherwise dispose of the product, offer to make, sell, hire or otherwise dispose of it, use or import it, or keep it for the purpose of doing any of those things; or

(b) where the invention is a method or process — use the method or process or do any act mentioned in paragraph (a) in respect of a product resulting from such use.”

Two types of patents are provided for by the *Patents Act*:

- (1) *Petty patent*. Petty patents provide for a 12-month term (which can be extended up to six years) for inventions with a limited commercial life such as simple gadgets and small household and office appliances (sec 68). Although the legal requirements are the same for petty patents and standard patents, the petty patent examination process is less rigorous and there is no provision for opposition proceedings.
- (2) *Standard patent*. Standard patents extend for 20 years from the date of the patent (sec 67).⁵⁷ A provisional specification may be lodged, after which the applicant must lodge a complete specification within the prescribed period (sec 38). Only the patent for a pharmaceutical substance can be extended (for four years) where a certificate of marketing approval has been given by the Department of Community Services and Health (sec 70-75).

¶3-600 What may be patented. Not all inventions can be patented. To be patented, an invention must: (1) be a new manner of manufacture, (2) which has an inventive step, (3) is novel, and (4) is useful.

(1) “*Manner of manufacture*”. Examples include: a new product such as a new drug; a new process, such as a new method of refining sugar or a new method of tenderising meat; an entirely new article or machine; a new method of using an old product, such as the use of a chemical, previously thought useful only as a paint additive, as a fertiliser.

57. The earlier period of 16 years in the *Patents Act* was raised to 20 years by amendments in the *Patents (World Trade Organization Amendments) Act 1994* (Cth), which came into effect on 1 July

1995. The term of existing standard patents which were due to expire on or after that date has been extended to 20 years (“transitional standard patents”).

— *Case example* —

Philips, which had patented its long-life energy-saving compact fluorescent lamp as a “low-pressure mercury vapour discharge lamp”, failed in infringement proceedings when Mirabella commenced distribution of its compact lamps. Philips’ argument that the lamps were “a new use of an old substance” was rejected because fluorescent tubes have been in use for a long time. Philips’ lamps were found not to be an “invention” under sec 18(1) and its patent was revoked under sec 138(3)(b) (¶3-630).

*N V Philips Gloeilampenfabrieken v
Mirabella International Pty Ltd*⁵⁸ —

The Act provides that “[h]uman beings, and the biological processes for their generation, are not patentable inventions” (sec 18(2)) (see below) whereas micro-organisms (sec 6), microbiological processes, living organisms and other life forms are patentable.

— *Case example* —

A method of weed control by spraying with a combination of known chemicals was held to be patentable. “The method cannot be classed as a variant of ancient procedures. It is additional to the cultivation. It achieves a separate result, and the result possesses its own economic utility consisting in an important achievement in the conditions in which the crop is to grow, whereby it is afforded a better opportunity to flourish and yield a good harvest.”

*National Research Development
Corporation v Commissioner of Patents*⁵⁹ —

(2) *Inventive step/novelty*. The invention must be novel. A wheel could not be patented, but a new way of using a wheel may be. Inventions are tested for novelty and inventive step under sec 7 by reference to prior disclosures (the “prior art base” defined in Sch 1).

(3) *Useful*. The invention must have some practical utility, be useful in its own right, and work: “If the patentee claims protection for a process for producing a result, and that result cannot be produced by the process ... the application fails.”⁶⁰

Genetically manipulated organisms. Although human beings and the biological processes for their generation are not patentable inventions (sec 18(2)), there are moves to provide patent protection for genetically manipulated organisms (GMOs) (including genetically modified animals or crops) or products produced by genetically modified organisms. Because of the research and testing involved, patent protection is seen to be comparable to patents for pharmaceutical products, and it would provide incentives to investment in and development of new products. Access to GMOs would provide benefits to the rural sector with improved animal and crop stocks.

58. (1995) 183 CLR 655.

59. (1959) 102 CLR 252.

60. *Re Alsop’s patent* (1907) 24 RPC 733 at pp 752-753.

Plant breeder's rights. Monopoly rights similar to patents for 20-25 years to innovators of plant varieties and the right to royalties are available under the *Plant Breeder's Rights Act 1994* (Cth). Plant breeder's rights are exclusive rights to sell or produce for sale plants or reproductive material, but they cannot be used to restrict sales of food, fuel, etc. A plant variety name is a name given to a particular "cultivar" or new type or variety of plant derived from a natural species and maintained by cultivation. Examples such as "Chameleon" and "Sultan", which are varieties of the rose family, indicate that a plant variety name is a variety, not a brand, of rose.⁶¹

¶3-610 Applying for a patent. A patent application by the inventor must comply with the formalities prescribed under sec 29, and must be accompanied by a complete specification or a provisional specification (standard patent) or a petty patent specification (petty patent). The drafting of a complete specification (especially) is a skilled task usually carried out by a "patent attorney" (a person such as an engineer registered under the *Patents Act 1990* (Cth) after having passed examinations and acquiring the necessary experience. Patent attorneys are given a statutory monopoly to transact all patent business, except conducting court proceedings).⁶²

Patent applications relating to nuclear technology (including enrichment or reprocessing of nuclear material and production of nuclear weapons) are to be referred by the Commissioner of Patents to the Director of Safeguards in line with the *Nuclear Non-Proliferation (Safeguards) Act 1987* (Cth).

The application must comply with the requirements of sec 29 (manner of new manufacture, invention, prescribed form) and be accompanied by a patent request and a specification.⁶³ Sections 41 and 42 contain special provisions for inventions involving micro-organisms.

- A provisional specification is usually lodged, which must be followed by a complete specification within 12 months (sec 29). Although describing the invention in general terms, a provisional specification establishes a date for the invention called the "priority date" (generally the date of filing; sec 43).
- A complete specification must accurately set out the nature of the invention claimed and the manner in which it is best performed. If it claims a patent for a new drug, it should include an account of both method of manufacture and method for effective use, ending with precise claims defining the scope of the patent, covering precisely what the inventor has contributed.
- Similarly, a petty patent specification describes the invention as does a

61. *A new class of personal property by statute* (1989) 63 ALJ 515; eg *Sun World Inc v Registrar of Plant Variety Rights* (1995) AIPC ¶91-195.

62. *Patents Act 1990* (Cth) sec 202.

63. An applicant for a patent has to make the nature of the invention clear to persons who have a reasonably competent knowledge of what was known before on the subject: *Samuel Taylor Pty Ltd v SA Brush Co Ltd* (1950) 83 CLR 617.

complete standard patent specification, but covers instead a single claim defining the invention. There is no provision for a provisional petty patent specification.

After the date of the advertisement of the acceptance of an application for a standard patent and complete specification, the Minister or any other person may oppose the grant of the patent under sec 59 on three grounds only: the applicant is not entitled to a grant of a patent, the invention is not a patentable invention under sec 18, or the specification does not comply with the requirements of sec 40.

¶3-620 Remedies for patent infringement. Infringement of a patent means interference with the patentee's "exclusive rights" provided by sec 13 (¶3-580) basically by copying goods or by contributory or indirect infringement. For example, if the use of goods would infringe a patent, sec 117 provides that supplying the goods would be an infringement of the patent unless the supplier is the patentee or licensee.

Infringement proceedings may be brought by the patentee (sec 120(1)). The exclusive licensee of a patent may sue for infringement if the patentee is a party to the proceedings either as a plaintiff or as a defendant (sec 120(2)).

Section 122(1) provides that infringement of a patent may be restrained by:

- an injunction — a stop order to prevent future infringement (eg ¶6-410, ¶8-810);
- damages — to provide compensation for past infringement; and/or
- an account of profits. Because the purpose of an account of profits is not to punish the defendant but to prevent unjust enrichment from past infringement, a proportion of the overheads in producing an infringing product is allowable as a deduction in the taking of the account of profits.⁶⁴

Damages or an account of profits will not be ordered for innocent infringement (sec 123(1)). Further, the defendant cannot claim the defence of innocent infringement if patented products are clearly marked as patented in Australia (sec 123(2)).

¶3-630 Revocation of patent. A patent may be revoked upon the petition of the Minister or any other person (sec 138), the grounds of revocation set out in sec 138(3) of the *Patents Act 1990* (Cth). These grounds include that the patentee is not entitled to the patent, that the invention is not a patentable invention and that the patent was obtained by fraud, false suggestion or misrepresentation.

64. *Dart Industries Inc v Decor Corporation Pty Ltd* (1993) 179 CLR 101.

¶3-640 International arrangements for patent registration.

Patents registered in Australia need to be registered overseas in order to obtain protection against appropriation of the patented technology in other countries. Patents obtained by Australian enterprises in other countries can facilitate the development of an export market. The process of international patents is simplified by Chapter 11 of the *Patents Act 1990* (Cth) which provides for the filing of a single international application (a PCT application) under the Patent Cooperation Treaty which is to be treated as an application under the Act for a patent in Australia.

¶3-650 Trade marks. Trade marks as a badge of origin for goods and services may be central to a business, very valuable, and require special legal protection. Registration of trade marks is provided for in the *Trade Marks Act 1995* (Cth).

The essential function of a trade mark is to indicate the origin of goods — to show a connection between the goods and the owner of the trade mark.

As defined in sec 17 of the Act, a trade mark is “a sign used, or intended to be used, to distinguish goods or services dealt with or provided in the course of trade by a person from goods or services so dealt with or provided by any other person.”

Use. The owner of the trade mark must use it or intend to use it, or else the trade mark may be removed for non-use under sec 92. Non-use may be a ground for opposition to registration under sec 59.

A “sign” is defined in sec 6 to include “any letter, word, name,⁶⁵ signature, numeral, device, brand, heading, label, ticket, aspect of packaging, shape, colour, sound or scent.”

— Case example —

The Coca-Cola Corporation, the manufacturer of a non-alcoholic cola flavoured carbonated beverage, has registered as a trade mark a contour drawing of the glass bottle in which the drink has traditionally been sold and the word marks “Coca-Cola” and “Coke”. The contour bottle has been in use in Australia since 1938. Even though Coca-Cola is sold mainly in cans (from the 1960s) and in plastic bottles (from the 1970s), a significant proportion of marketing uses or promotes the image of the contour bottle. Coca-Cola was successful in obtaining a court order to restrain a confectionary importer from distribution of lollies in the shape of the Coke bottle on the basis that its use contravened the Coca-Cola trade mark.

_____ *Coca-Cola Company v All-Fect Distributors Ltd t/a
Millers Distributing Company*⁶⁶ —

The definition of “sign” is comparable to the definition of trade mark in the United Kingdom and the EU which complies with GATT principles

65. eg sporting personalities such as Damon Hill and Jaques Villeneuve have registered their names and likenesses as trade marks.

66. [1999] FCA 1721; (2000) ATPR ¶41-735; ¶7-280.

— namely any sign which performs the function of indicating the commercial origin of goods and services, provided the sign is capable of graphic representation.

A colour may be registrable as a trade mark if the applicant can show that it has acquired meaning as a trade mark. For example, in an American case, the applicant was not able to register the colour red for its pocket knives as it could not show that red was a symbol to distinguish its knives from those of its competitors.

A web site (or domain name) may be registered as a trade mark if its purpose is to indicate a connection in the course of trade between the applicant and its goods or services.

— *Case example* —

P, the registered owner of the trade mark JURIS under US trade marks law, sued D for trade mark infringement (§3-680) by its domain name www.juris.com which D used for its legal information website. P was awarded an injunction which precluded D using the domain name “or any confusingly similar variation”.

————— *Comp Examiner Agency Inc v Juris*⁶⁷ ———

The first sound was accepted for registration as a sound mark in 1998, on the basis that it was able to distinguish the goods and/or services of the applicant from those of other traders (§3-670). The application consisted of a written description of the sound, with a tape recording of the sound.⁶⁸

¶3-660 Registrable trade marks. The *Trade Marks Act 1995* provides for a Register of Trade Marks to be kept at the Trade Marks Office, administered by the Registrar of Trade Marks (sec 207).

Part 7 — Registration of trade marks. An application for the registration of a trade mark must be rejected if the trade mark is not “capable of distinguishing” the applicant’s goods or services (sec 41(2)).

A trade mark’s capability to distinguish may arise from, among other things:

- (1) the inherent characteristics of the mark, such as an invented word, or
- (2) the extent to which the applicant for registration has used the trade mark.

For example, registration was allowed under the *Trade Marks Act 1955* of a trade mark with no inherent distinctiveness, such as “WHOPPER” in respect of hamburgers, as it had achieved distinctiveness through use.

67. Central District of California Court, 1996, noted Hakim, S, *Trade marks in the Internet era: domain name disputes* (1999) 73(3) LJ 58.

68. Freehills Patent Attorneys, *In depth*, Issue 2, p 12 (June 1998).

— *Case examples* —

The proprietor of the registered trade mark “Mortein” applied for registration of a trade mark consisting of the word “Mortein” in bold letters superimposed on the smaller words “PRESSURE*PAK”. The proprietor argued that the words were in no way descriptive of insecticides, or if they were, they were adapted to distinguish the goods under sec 16(2) and were therefore registrable. Registration of the application as a trade mark was refused on the grounds that it was exclusively descriptive of the character or quality of insecticides when sold in pressurised containers. Distinguishing the insecticide when prepared for use in an aerosol container from the insecticide when sold in bottles or metal containers was the only distinctive character which the words were found to have. The words were not registrable under the equivalent of *Trade Marks Act 1995* (Cth) sec 41. The proprietor refused to disclaim exclusive use of the words “Pressure Pak”.

*Samuel Taylor Pty Ltd v Registrar of Trade Marks*⁶⁹ —

The mark consisting of the words “NO FRILLS CAR RENTALS” on a hexagon was refused registration as a mark for a motor vehicle rental business because the words referred to the character or quality of the services (as being without extras or embellishments) and neither these words nor the hexagon were distinctive and capable of registration.

*Re Bykerk Holdings Pty Ltd*⁷⁰ —

Part 15 — Collective trade marks. These are trade marks used by an association (§9-630) which can be registered in the name of a member of the association (sec 162). They are to be distinguished from a trade mark of a member of the association.

Part 16 — Certification trade marks. A certification mark is one which indicates that the goods or services to which it is applied have satisfied a particular standard — for example the Woolmark. A person applying to register a certification mark must also file a copy of the rules governing the use of the mark. If the Registrar approves the application it must then be sent to the Australian Competition and Consumer Commission for approval (sec 174–176). The task of deciding whether the applicant is competent to certify the goods or services, whether the draft rules are satisfactory and whether the registration would be to the public advantage was left to the Registrar under the *Trade Marks Act 1955*. This role has now been given to the ACCC to ensure that the granting of certification marks does not result in restrictive trade practices or conduct which is likely to mislead or deceive customers.

Part 17 — Defensive trade marks — A well known mark may be registered under Part 17 to prevent its use by others for a different class of goods or services not covered by Part 7 registration (sec 185). It may be registered as a defensive trade mark even if the proprietor does not intend to use it. For example, if an unconnected business used a trade mark well known in respect

69. *Samuel Taylor Pty Ltd v Registrar of Trade Marks* (1959) 102 CLR 650.

70. *Re Bykerk Holdings Pty Ltd* (1992) AIPC ¶90-930.

of cars such as “Ford” or “Holden” on, say, car tyres, this use might indicate a connection between those tyres and Ford or Holden. Registration of such words as a defensive trade mark may stop the possibility of such connection being made.

¶3-670 Trade mark registration. The procedure for registration of a trade mark is set out in Part 4 of the *Trade Marks Act 1995* (Cth). Applications for registration are examined for their validity against existing registrations and whether there are grounds for rejection under Part 4 Div 2.

An application *must* be rejected if:

- it contains or consists of a sign prohibited by regulation (sec 39(1));
- it cannot be represented graphically (sec 40);
- it does not distinguish the applicant’s goods or services (sec 41(2));
- it consists of scandalous matter or its use would be contrary to law (sec 42);
- its use would be likely to deceive or cause confusion (sec 43);
- it is substantially identical with, or deceptively similar to, a trade mark registered by another person (sec 44). “Deceptively similar” is defined in sec 10 to mean that the trade mark “so nearly resembles that other trade mark that it is likely to deceive or cause confusion”.

— *Case example* —

The funship. Opposition under the 1955 Act by P (a Panama-incorporated shipping company) to registration by D (British-incorporated Sitmar Cruises Ltd) of the trade marks “SITMAR’S FUNSHIP”, “FAIRSTAR THE FUNSHIP” or “FUNSHIP” was dismissed. P promoted its ships and cruises in the Caribbean Sea under the name “THE FUN SHIPS” and “FUN SHIP cruises”. Even though P’s brochures circulated in Australia, it was held on the basis of the small number of bookings from Australia that P did not have the necessary reputation in its mark to cause a substantial number of people to be deceived or confused by D’s registration of the FUNSHIP trade mark.

— *Sitmar Cruises Ltd v Carnival Cruise Lines Inc*⁷¹ —

If the application is in order, it is advertised and interested parties have the right to oppose registration (sec 52). Grounds for opposing registration include the same grounds as for rejection under Part 4 Div 2 listed above (sec 57): the applicant is not the owner of the trade mark (sec 58), the applicant does not intend to use the trade mark (sec 59), the trade mark is similar to a trade mark with an existing reputation (sec 60) or a trade mark in respect of wine contains a false geographic indication (sec 61).

Initial registration is for 10 years and it can be renewed indefinitely for successive periods of 10 years (sec 72). Once registered under the Act, the

71. (1992) AIPC ¶90-939. With examples of confusion cases, see eg Donaldson, A,

Trade marks — confusion, worse confounded (1989) 11 LSB 256.

applicant becomes the “registered owner” (sec 6; Part 7)⁷² with the exclusive rights:

- to use the trade mark (sec 20(1)(a));
- to authorise other persons to use the trade mark (sec 20(1)(b)) (with the right to prevent anyone else from using the mark);
- to sue for infringement of the trade mark (sec 20(2)) under sec 126; and
- to “deal with the trade mark as its absolute owner” (sec 22(1)), bearing in mind that “equities in respect of a registered trade mark may be enforced in the same way as equities in respect of any other personal property” (sec 21(2)) (¶3-210).

¶3-680 Trade mark infringement. Part 12 of the *Trade Marks Act 1995* (Cth) deals with infringement of trade marks. A trade mark is infringed:

- by the use as a trade mark of a sign⁷³ “substantially identical with, or deceptively similar to” a registered trade mark (sec 120(1)); or
- by the use as a trade mark of a sign “substantially identical with, or deceptively similar to”
 - existing registered goods (sec 120(2)(a)); or
 - services closely related to registered goods (sec 120(2)(b)); or
 - services of the same description as registered services (sec 120(2)(c)); or
 - goods closely related to registered services (sec 120(2)(d))
 if using the sign is likely to deceive or cause confusion;
- if a person uses as a trade mark a sign in respect of unrelated goods or services that is “substantially identical with, or deceptively similar to” a trade mark “well known in Australia” (sec 120(3)).

The Act states that certain actions do not constitute an infringement including:

- the use by a person of the person’s own name, or the name of the place of business (sec 122(1)(a)) (cf ¶12-040);
- the use in good faith by a person of a description of the character of that person’s goods or services (sec 122(1)(b));
- comparative advertising (sec 122(1)(d));
- use with the consent of the registered owner (sec 123); and
- prior use of an identical trade mark (sec 124).

72. The *Trade Marks Act 1995* (Cth) used the word “proprietor”. No difference in meaning is intended by the use of the

simpler word “owner” in the *Trade Marks Act 1995* (Cth).

73. “Sign” is defined in sec 6: see ¶3-650.

A registered trade mark may be protected by legal action for:

- (1) infringement, where remedies can include an injunction and damages, or an account of profits (sec 126). Damages are not to be awarded for infringement if the defendant has applied to the court for an order to remove the trade mark from the Register for non-use (sec 92(4));
- (2) the tort of passing off — to prevent a claim by another person that “his goods are yours”⁷⁴ (¶12-030);
- (3) breach of confidential information (¶3-685);
- (4) misleading or deceptive conduct under sec 52 of the *Trade Practices Act* 1974 (Cth): ¶7-280; ¶12-050.

Part 13 of the *Trade Marks Act* 1995 (Cth) protects trade marks by allowing Customs to seize and deal with goods that are imported into Australia if the importation infringes an Australian trade mark.

¶3-685 Breach of confidential information. In addition to the statutory remedies mentioned in ¶3-680 above, the common law provides remedies for passing off (¶12-030) and for breach of confidential information.

An obligation of confidence may exist even if there is no contractual relationship between the parties. Action for breach of confidence (or breach of confidence in relation to confidential information) restrains a person from using or passing on, without permission, information received in confidence.

An obligation of confidence may arise from the employer/employee relationship as an express or implied term of the contract of employment, and the following principles apply to the employee. Although confidential information of the employer is further protected by contractual restraints (as discussed at ¶5-850), an ex-employee is free to use general knowledge and skill learned in the course of former employment.

Elements of action. For breach of confidence to be established, the following elements must be proved:

1. The information must be secret or confidential — it must have the necessary quality of confidence about it, and must not be public knowledge. Before information or an idea can be recognised as confidential information, it must be able to be identified with precision and not just in general terms.

Confidential information includes commercial information such as data, plans, customer lists, the idea for a TV series (as in the *Rock Follies* case below), and importantly in the employer/employee context, a “trade secret” — information relating to the business which ought not

74. Heydon, JD, *Economic Torts*, London, Sweet & Maxwell, 2nd ed, 1978, p 88.

to be disclosed.⁷⁵ Government information which is not already public property may also be confidential information.⁷⁶

2. The information must have been given in circumstances where the recipient knew or should have known that it was confidential.
3. There must be an unauthorised use of the information to the detriment of the person communicating it. The public in a democratic society needs access to government information, and one restraint on the publication and use of government information is the test of the *public interest*.⁷⁷ The *general iniquity* test is also a defence (or justification) to an action for breach of confidence.

— *Case examples* —

“Rock Follies”. In 1973, three actors formed a rock group called “Rock Bottom” with Donald Fraser as their composer and manager. They developed an idea for a TV series based on the experiences of the three as individuals and as the three-girl rock group. Negotiations took place with a scriptwriter, TV producers and the Head of Drama and other representatives of the English company Thames Television, and Thames made a payment to the four to secure an option (¶5-365) pending a final decision.

Thames decided to go ahead with the series, but as one of the three actors was unavailable at the time because she was appearing in a musical, Thames proceeded with Rock Bottom’s TV series under the name “Rock Follies” with three other actors. Rock Bottom successfully sued Thames Television for breach of confidence and for breach of contract.

Breach of confidence. The court confirmed that where there has been an oral communication of an idea made in confidence, the recipient is under an obligation not to use the idea without the maker’s permission. In this case, the scriptwriter, Thames and its producer knew that the idea was Rock Bottom’s and by participating in “Rock Follies” they were all in breach of their obligation of confidence to the members of Rock Bottom. The idea did not lose its confidentiality once disclosed to others in the course of negotiations.

Breach of contract proved. The use of Rock Bottom’s idea with three new actors was a breach of an implied negative covenant (¶6-110) that if the three Rock Bottom actors were available, Thames would not proceed with their idea without using them in the series. Under the option agreement, the Rock Bottom actors were entitled to a contractual offer of the parts. Recasting all the Rock Bottom parts was a wrongful repudiation by Thames constituting breach of contract.

— *Fraser v Thames Television Ltd*⁷⁸ —

The court issued an injunction to a visiting pop star to restrain circulation of a video made of him with a female in a hotel bedroom. The video was

75. eg *Searle Australia Pty Ltd v Public Interest Advocacy Centre* (1992) 108 ALR 163 at p 171.

76. *Commonwealth of Australia v John Fairfax & Sons Ltd* (1980) 147 CLR 39.

77. *Commonwealth of Australia case*, above, at pp 51, 52.

78. [1984] 1 QB 45; ¶6-110, applying *Talbot v General Television Corporation Pty Ltd* [1980] VR 224.

made without his knowledge and the court order was made on the basis of breach of confidence.

_____*Kwok v Thang*⁷⁹_____

Remedies. Remedies for a breach of confidential information include legal remedies such as damages, and equitable remedies such as:

- an injunction to restrain disclosure or use of the information (§6-410);
- an account of profits for improper use of the confidential information as an alternative to damages;
- an order for delivery up or destruction;
- an order for seizing evidence (an Anton Piller order: §6-416).

Defences. Action for breach of confidence will fail if any of the three elements discussed have not been fulfilled. In particular, disclosure of information given in confidence will be permitted if in the public interest.⁸⁰

§3-690 Limitations on intellectual property law. The statutory monopoly given by designs, patents and trade marks law and the legal rights given to the copyright holder can enable the registered proprietor to charge monopoly prices. Because patents, trade marks, designs, copyrights and circuit layouts receive an extensive exclusion from the operation of Part IV of the *Trade Practices Act 1974* (Cth) by sec 51 (§8-020) (but not sec 46 (misuse of market power) or sec 48 (resale price maintenance)), anti-competitive behaviour may result from the monopoly of the owner or proprietor.

§3-695 Intellectual property in an electronic world. The traditional laws — case law and statute — continue to apply to the rapid development of electronic commerce and the Internet, such as the criminal law (§2-300), contract law (§5-015) and the traditional intellectual property laws introduced in this chapter:

(1) copyright. Difficulties in the application of the eighteenth century concept of copyright to e-commerce in Australia include:⁸¹

- The fact that material appears on a website does not mean that it is in the public domain and that it may be copied at will.
- Copyright may be infringed by copying a website or by creating and maintaining hypertext links to other websites.
- Copyright law does not recognise a “multimedia” work, and copyright attaches to each of its various elements.

79. [1999] NSW SC 1034, noted at (1999) 73 ALJ 874.

80. As stated in the *Commonwealth of Australia* case, above.

81. Clarke, R and Dempsey, G, *Copyright implications of electronic publishing* (1999) 11(8) IPLB 77.

- Copyright law in some jurisdictions has held the “look-and-feel” of the user interfaces of software products such as spreadsheet modellers to be subject to copyright.
- “Add-ons” to software packages have been attacked by the owners of the rights to the product that the add-on extends or complements.
- Legal restraints have been imposed on “reverse engineering” (the *Autodesk case*: ¶3-505).

The *Copyright Amendment (Digital Agenda) Bill 1999* (Cth) is intended to introduce the most significant and comprehensive reforms to Australian copyright law since the *Copyright Act* was passed in 1968: ¶3-545.

(2) designs. The ALRC has recommended that the *Designs Act 1906* (Cth) be modernised and simplified to allow greater innovation in the design of manufactured products: ¶3-550.

(3) patents. Electronic commerce technology — such as an electronic payment system, a secure method for communicating credit card data, digital signature verification technology and a virtual reality generator for use with financial information — can be protected by patent if it fulfills the above tests. Patents can also protect the technology underlying e-commerce products, such as encryption, compression and authentication algorithms. The test of the Patents Office of whether a computer-related invention is patentable is whether the “invention claimed involves the production of some commercially useful effect”. Hence, “if technology is involved in implementing a new financial product or business model, then this technology can be patented. A well drafted patent over the technology may provide protection for the financial product or business model itself.”⁸²

(4) trade marks. As discussed at ¶3-650, a website or domain name may be registered as a trade mark. It may be protected by the law of passing off (¶12-030) and by action for conduct which is misleading or deceptive under sec 52 of the *Trade Practices Act* (¶7-280).

— Case example —

Netscape and Excite sell advertising space on their banner ads in their search engines on the Internet. When they sold advertising space to proprietors of adult entertainment websites who used the words “playboy” or “playmate”, Playboy Enterprises Inc sued for infringement of its registered trademarks “Playboy” and “Playmate”. Playboy was unsuccessful on the basis that Netscape and Excite did not use the words to identify any goods or services and therefore did not use them as trade marks.

— *Playboy Enterprises Inc v Netscape Communications Corp and Excite Inc*⁸³ —

82. Swinson, J, *Patents in cyberspace* (1998) 11(5) IPLB 52; Swinson, J, *Patenting electronic commerce* (1999) 12(3) IPLB 29 at pp 31, 32.

83. US District Court, 24 June 1999, discussed by Wise, D, Sutton, L and Hansen, P, *Internet advertising: impact of the recent Playboy decision* (1999) 12(3) IPLB 27.

Applying old rules to new situations can have unintended consequences, particularly when the old rules are technology specific, as was evidenced by the music on hold cases.

The High Court held that Telstra’s provision of music for telephone users while on hold constituted an infringement of copyright unless Telstra was licensed by the owner of the copyright. This decision may impact on ISPs (Internet service providers), as transmission of copyright material by a service provider on the Internet to its customers may infringe copyright unless the service provider is licensed by the copyright owner. It may prove to be a practical impossibility for a service provider to get a licence for all the material distributed, unless a licence can be implied by the act of placing material on the Internet. *Kirby J* was conscious of the implications of this decision, and pointed to the future in the following paragraph:⁸⁴

“It has been suggested that the foregoing conclusions could have significant consequences for other information technologies—including facsimile services, video conferencing and data transmission. ... In particular, it has been argued that telecommunications carriers and perhaps even Internet service providers could potentially become liable as a result of Internet users’ downloading works which are protected by copyright. Clearly, such issues go beyond the scope of this appeal. They were not developed in the arguments of the parties. However, the Parliament may need to consider these questions—and others arising—and to formulate a legislative response to them. They cannot be solved, but have not been overlooked, by me.”

WILLS AND SUCCESSION _____

Definition of a will ¶3-700
Intestacy ¶3-705
Freedom to will? Testator’s family maintenance ¶3-710
Probate and administration ¶3-720
Executors and administrators ¶3-730

¶3-700 Definition of a will. The law of succession is the study of inheritance and the passing of property on death with or without a will.

A will is a declaration of the intention of the person making it (the testator) made in a prescribed manner concerning matters which the testator wishes to take effect upon or after death. A will must comply with many formalities, as set out below. The law recognises a *holograph will* (written entirely in the testator’s own handwriting), and it may recognise a *nuncupative or oral will* in the case of a member of the armed services on active duty (a declaration by the testator without any writing made before a sufficient number of witnesses).

A will does not operate until the testator’s death and, as it is a mere declaration of intention made during the testator’s lifetime, it can be freely

84. *Telstra Corporation Ltd v Australasian Performing Right Association Ltd* (1997) AIPC ¶91-344 at p 39,600; (1997) 71 ALJR 1312 at p 1345.

revoked or altered. Under a will a testator normally appoints an executor(s) or others to manage his or her affairs at death, appoints guardians of minor children and disposes of property expected to be owned at death. Real and personal property (¶13-020) owned by the testator at the date of death can be transferred by will whether or not it was owned when the will was executed.

Property which may be disposed of by will. A person may dispose of any property which that person is entitled to at the time of death, whether or not the person was entitled to it when the will was made. If the testator is entitled to property which is not covered by the will, that property will pass on intestacy, and the testator will be partially intestate.¹

Formalities of a will. For a will to be valid, the law requires:²

- (1) writing;
- (2) signature at the foot or end by the testator (or by another person in the presence of and under the direction of the testator). In New South Wales, Victoria and Western Australia, for example, there is no requirement for the testator's signature to be at the foot or end of the will. Rather, the will must be signed in such place that it is apparent on the face of the will that the testator intended to give effect by the signature to the writing signed as the will;
- (3) the making or acknowledging of the signature by the testator to be in the presence of two or more witnesses present at the same time. Under the "witness/beneficiary rule", beneficiaries under a will and their spouses ("interested witnesses") should not witness the will, as generally gifts to those beneficiaries will fail:
 - the witness/beneficiary rule does not apply in Victoria, South Australia or the ACT;³
 - in New South Wales, Western Australia and Tasmania, the witness/beneficiary rule does not apply if there are two other witnesses in addition to the beneficiary.⁴

1. eg *Wills, Probate and Administration Act 1898* (NSW) sec 5; *Wills Act 1997* (Vic) sec 4; *Wills Act 1936* (SA) sec 4.

2. *Wills, Probate and Administration Act 1898* (NSW); *Wills Act 1997* (Vic), noted Sparke, C, *Where there's a will ... there's a way* (1998) 72(1) LIJ 34; *Succession Act 1981* (Qld); *Wills Act 1936* (SA); *Wills Act 1970* (WA); *Wills Act 1992* (Tas); *Wills Act 1968* (ACT); *Wills Act 1938* (NT). Nationally uniform and up to date laws in the areas of wills, family provision, administration of estates and intestacy has been recommended by the National

Committee for Uniform Succession Laws in its report on the Law of Wills and Family Succession, presented to the Standing Committee of Attorneys-General, December 1997, noted (1998) 72 ALJ 249; updated, Reform, Issue 76, p 114 (Autumn 2000).

3. *Wills Act 1997* (Vic) sec 11; *Wills Act 1936* (SA) sec 17; *Wills Act 1968* (ACT) sec 15.

4. *Wills, Probate and Administration Act 1898* (NSW) sec 13(2)(a); *Wills Act 1970* (WA) sec 13; *Wills Act 1992* (Tas) sec 44-46.

- in Queensland, the rule applies to interpreter/beneficiaries.⁵
 - In New South Wales and Tasmania, the rule does not apply if the beneficiary has consented in writing, or if a court is satisfied that the testator knew and approved of the gift and made it voluntarily.
- (4) attestation and subscription of the will by those witnesses in the presence of the testator;
- (5) “testamentary capacity” — the testator must be of sound mind, memory and understanding, and have attained the age of 18 (§5-520—§5-535).⁶

In some jurisdictions, a minor may make a will:

- if the minor is married, or
- if the minor contemplates marriage,⁷ or
- by authority of the court if “reasonable in all the circumstances”.⁸ It could be reasonable for a minor with assets or a minor brought up by a foster family to make a will to dispose of their own property.

Forfeiture. Under the forfeiture rule, the killer of a person — whether or not there has been a criminal conviction — cannot take under that person’s will. This rule is relaxed by legislation in some jurisdictions.⁹

Privileged wills. Wills laws in many jurisdictions give privilege from the formalities of will making — such as the need for writing — to certain testators in difficult situations. Privileged testators include members of the army, navy or air force while on active service, members of philanthropic organisations such as the Red Cross, and prisoners of war.

Dispensing power of the court: statutory wills. If the formal requirements are not satisfied, the court is able to dispense with them if there is evidence that the testator intended the document in question to operate as a will. For example, a minor’s will may be authorised (see above). In some jurisdictions, the court may permit a “statutory will” by a person lacking will-making capacity.¹⁰ For example, a young woman aged 17, a “street kid” with a rare illness, was about to have surgery with a 50% success rate. Her wish to make

5. *Succession Act 1981* (Qld) sec 15A.

6. eg *Wills Act 1997* (Vic) sec 5; 1970 (WA) sec 7; *Succession Act 1981* (Qld) sec 8(1). In some jurisdictions wills may be made by an under-age “privileged testator”, ie in general any member of the armed services of any country, a married or previously married minor, a minor in contemplation of marriage (becoming valid upon marriage) or by court order.

7. *Wills Act 1997* (Vic) sec 6; *Wills, Probate and Administration Act 1899* (NSW) 6B.

8. *Wills Act 1997* (Vic) sec 20; compare *Wills, Probate and Administration Act 1898* (NSW) sec 6A.

9. eg *Forfeiture Act 1995* (NSW); 1991 (ACT).

10. eg Bruggemann, R and Bidmeade, I, *Intellectual disability and valid wills*, LSB, Vol 13, No 10, p 17 (November 1991).

a will giving her estate of less than \$2,000 to a friend who had helped care for her in “the squat” was approved by the court.¹¹

Informal wills. Sometimes a will may have a defect such as being unsigned, unwitnessed or partially witnessed (“attested”), altered or incomplete or in draft. In many jurisdictions,¹² the court has discretionary power to dispense with the statutory formalities and to recognise a document apparently setting out the deceased’s testamentary intention as a will, an amendment or a revocation if there is evidence that the deceased intended the document to be his or her will. Documents which have been held not to qualify as an informal will include instructions for a will, lists of proposed legacies and bequests, an unattested (unwitnessed) codicil and a provision in a mortgage.¹³

Wills executed overseas. Generally a will executed overseas by a testator connected to the overseas jurisdiction will be accepted in Australia if it conforms to the law of the overseas jurisdiction.¹⁴

Interpretation of the will. The will takes effect from the death of the testator, unless there is an intention to the contrary. After the death of the testator, the executor applies for probate of the will — this is a court order which “proves” the will and confirms the authority of the executor (§13-720).

Sometimes it may be difficult for the executor to interpret the will and to work out what the testator intended, and if so the executor can apply to the probate court for a ruling to give effect to the intention of the testator. For example, before specific legislation was passed to clarify the issues,¹⁵ the court sometimes had to decide if “children” included illegitimate children.

Alteration of a will. To give effect to the presumed intention of the testator, the law refuses to recognise obliterations, interlineation or any other alteration in a will made after its execution, unless such alteration, etc is executed in a like manner to that required for the execution of the will. An invalid alteration will be disregarded, and the will as originally executed admitted to probate, if the words or effect of the will before the alteration was made are apparent. However, a will can be altered by a “codicil” (a supplement or addition to a will) made by a testator, annexed to and to be taken as part of the will. A codicil must be signed by the testator with the same formalities as a will and, like a will, it can be revoked.

Revocation of a will. A will can be cancelled or revoked at any time by a testator with full capacity by:

11. Powell, J, *Recent developments in New South Wales in the law relating to wills* (1993) 67 ALJ 25 at p 27; see Atherton, R, *Moot point: informal wills and revocation* (1999) 73 ALJ 315 for further examples of the dispensing power of the court; *Validity of unsigned wills* (1999) 73 ALJ 805.

12. Such as Qld, SA and NT.

13. Powell, *op cit*, p 36. See also, eg, Hardingham, I, *A will or waste-paper?* (1992) 66 LIJ 764.

14. eg *Wills Act 1997* (Vic) sec 17; 1970 (WA) sec 21.

15. eg *Children (Equality of Status) Act 1976* (NSW).

- a later will or codicil containing a revocation clause (if there is no revocation clause, the later will will revoke to the extent of any inconsistency with the former);
- writing declaring a clear intention to revoke the will, executed with the same formalities as the will;
- burning, tearing or otherwise destroying the will by the testator or another person in the presence of the testator and by the testator's direction, with the intention of revoking the will;
- subsequent marriage or remarriage of the testator. This rule has two exceptions:
 - if the will was made in contemplation of marriage, and refers, for example, to "my fiancée". Some jurisdictions allow extrinsic evidence to prove that marriage was contemplated.
 - if the will was made in exercise of a power of appointment of property, ie the testator has appointed a person (a "donee") to do something with the testator's property.
- subsequent divorce of the testator. In most jurisdictions subsequent divorce revokes any gifts to the former spouse and revokes any appointment of the former spouse as executor, trustee or guardian unless confirmed in the will. Gifts to the children of the marriage or other beneficiaries are not affected by the divorce.

Undue influence. A will may be set aside if there is evidence that the mind of the testator was affected by undue influence such as the unconscionable use of a position of influence by the donee over the donor amounting to force or coercion so as to gain an advantage under the will.¹⁶

Rectification of a will. A court may be able to correct or rectify a will which does not truly reflect the stated intentions of the testator, if there is clear proof of error. At common law, the court's power is to delete words which have been added by mistake but, in certain jurisdictions, the court has a statutory power to add words which have been inadvertently left out.

Revival of a will. A will or codicil which has been revoked or partly revoked can be revived by re-execution according to the formalities required for a valid will.

Missing wills. There is a presumption that a will has been revoked if it is missing. The presumption can be rebutted with evidence.

— *Case example* —

Brett Whiteley's will. Australian artist Brett Whiteley died in June 1992. He had made a valid formal will properly witnessed by two people in May 1989 just before his divorce from Wendy Whiteley, and this will was not revoked

16. *Winter v Crichton; Estate of Galieh* (1991) 23 NSWLR 116, noted (1992) 66 ALJ 538.

by his subsequent divorce because it had left nothing to his former wife. (If it had, any gifts to a former wife would have been revoked by the *Wills, Probate and Administration Act 1898* (NSW) sec 15A.) Had any of the following other documents revoked the will?:

January 1991: an apparently formal will properly witnessed by two people but since disappeared, which gave rise to the presumption of revocation of the will of May 1989. One of the witnesses was a residuary beneficiary and the will might have been affected by the witness-beneficiary rule, but this rule would have been dispensed with by the court under NSW sec 13(2)(c) on the basis that the deceased knew and approved of the gift and gave it freely and voluntarily.

April 1991: an informal will, originally taped under a drawer in the artist's studio, but since disappeared. Disappearance also gave rise to the presumption of revocation. This will was signed by the artist, but witnessed by only one person (who noted its existence, location and contents in an exercise book). The court exercised its power under NSW sec 18A to dispense with formal requirements on the basis of evidence that the deceased intended the document to constitute his will. Evidence of the artist's daughter showed that the presumption of revocation was rebutted, and that this will represented the artist's intentions.

May 1991: an informal unwitnessed document — perhaps a codicil — in Whiteley's handwriting. It was in precatory language (words of request or hope) but it was consistent with the earlier wills.

The presumption of revocation was rebutted and Whiteley's estate was to be distributed according to the will of April 1991.

_____ *Whiteley v Clune; The estate of Brett Whiteley*¹⁷ —

Nominations and testamentary dispositions. Not all acquisitions of property on the death of another, such as the transfer of a joint bank account or the nomination of the beneficiary of a death benefit payable under an employee pension scheme, are by will. In the words of the High Court, "Succession *port mortem* is not the same as testamentary succession":¹⁸ this technical difference is important if the ostensibly *inter vivos* arrangement really is a will, because the transfer may fail if the will formalities listed above are not complied with.

¶3-705 Intestacy. A person who dies without a will, or whose will is invalid, dies "intestate". A person who does not dispose of all property by will, or whose will is partially invalid, dies partially intestate.

An intestate estate is handled by an administrator — normally the surviving spouse or other close relative.

17. Supreme Court of NSW, 13 May 1993, unreported, noted [1993] ACL Rep 395 NSW 18, 20; (1993) 67 ALJ 859.

18. *Russell v Scott* (1936) 55 CLR 440, per Dixon and Evatt JJ at p 454, discussed

further by Atherton, R, *Nominations and testamentary dispositions* (1991) 65 ALJ 49.

Generally, the legislation¹⁹ provides an amount for the surviving spouse as well as the household chattels, with the remainder of the estate (if any) going to the spouse and children. If there are no children, the whole intestate estate normally goes to the spouse. If there is no spouse, all jurisdictions provide that the estate normally goes to the children. If there is no spouse or children, the estate normally reverts to the parents, and if they are dead, to brothers and sisters. Other rules apply to those who are unmarried.

There are differences among the jurisdictions on the definition of “spouse”, and some jurisdictions include a de facto spouse, a spouse of the same sex²⁰ and a spouse under an aboriginal customary law marriage.²¹

¶3-710 Freedom to will? Testator’s family maintenance.

The freedom to distribute property in a will is limited by the provisions of the family provision or testator’s family maintenance laws which allow certain dependent applicants to challenge a will. This legislation was passed for “the assurance to the family of a deceased person and certain other persons of adequate provision from the estate of the deceased person and certain other property” (eg “notional estate” such as property held in trust).²² The legislation authorises the court to make provision from the testator’s estate for the benefit of dependants of the deceased: the categories of dependants vary among the jurisdictions, from the widest in Victoria²³ to the narrowest in Tasmania.²⁴

Categories of dependants of the testator include all or some of the following:

- widow, widower, former spouse, same sex partner;
- children, stepchildren, foster children, grandchildren;
- parents of the deceased; and
- long term friend, carer and/or housekeeper.

19. eg *Succession Act 1981* (Qld) Pt 3; *Inheritance (Family and Dependents Provision) Act 1972* (WA) sec 6, 7; *Testator’s Family Maintenance Act 1912* (Tas) sec 3A; *Family Provision Act 1969* (ACT) sec 7; *Family Provision Act 1970* (NT) sec 7.

20. eg ACT sec 7(1)(b) (“domestic partner”); cf *Who is a family member in a homosexual relationship?* (2000) 74 ALJ 96.

21. eg NT sec 7(1A).

22. Preamble to the *Family Provision Act 1982* (NSW); see also *Administration and Probate Act 1958* (Vic); *Succession Act 1981* (Qld); *Inheritance (Family*

Provision) Act 1972 (SA); *Inheritance (Family and Dependents Provision) Act 1972* (WA); *Testator’s Family Maintenance Act 1912* (Tas); *Family Provision Act 1969* (ACT); *Family Provision Act 1970* (NT). See further Cook, R, *Keeping it in the family — TFM and family farms and businesses*, LJ, Vol 70, No 11, p 42 (1996); Barton, P, *TFM — the new regime*; (1998) 72 LJ(2) 40; cf ¶3-240.

23. *Administration and Probate Act 1958* (Vic), sec 91, amended 1997: “a person for whom the deceased had responsibility to make provision”.

24. *Administration and Probate Act 1935* (Tas).

A dependant who is left out of a will may challenge it under this legislation for a court order to overturn the testator's intention. To do so, the dependant must establish the need for "proper maintenance and support" or a moral claim under the will. Claims of others will be balanced, as well as the conduct of the applicant towards and the applicant's relationship with the deceased.

A will, and in particular a pre-death disposition, may also be challenged under the unconscionability principles of *Amadio's case*: ¶5-730.

¶3-720 Probate and administration

Personal representative of the deceased. Upon the death of a person, several things have to be done by the "legal personal representative" — the generic expression used for the executor or the administrator of the estate. After the funeral of the deceased, the legal personal representative of the deceased stands in the place of the deceased to collect the assets and to pay the debts of the deceased. If the deceased has left a will, the representative appointed in the will is called the *executor*. If there is no will (or if the will does not appoint an executor or the executor has predeceased the deceased or has declined to act) the legal personal representative is called the *administrator*.

The authority of the representative to attend to the deceased's affairs is provided by the authority of the Supreme Court:

- for an executor, in the form of a Grant of Probate. This is a document sealed by the court, reciting the death of the deceased and that probate of that will (a copy of which is attached to the probate) has been granted to the person named as executor;
- for an administrator — usually a relative of the deceased — in the form of a Grant of Letters of Administration.

Differences between executor and administrator. Although each representative is authorised by the court to stand in the place of the deceased and can produce the probate/letters of administration to collect, realise and distribute the deceased's estate, there are important differences between the two offices:

- (1) An executor is nominated by the testator in the will, whereas an administrator applies to and is appointed by the court.
- (2) Neither an executor nor an administrator has power to deal with the estate until a Grant of Probate²⁵ or of Letters of Administration has been made. When the Grant is made it operates retrospectively to the date of death. The power of the executor to act cannot be limited by any direction in the will and the testator cannot specify conditions or priorities on the exercise of the executor's power.
- (3) Before Letters of Administration are granted, an applicant must lodge an Administration Bond (often arranged through an insurance company)

25. A Grant of Probate is a court certificate saying that the will is valid, and that the executor has the right to administer the

estate. See generally Graham, PR, *The substantial validity of wills* (1998) 72 ALJ 889.

as security for due administration of the estate unless dispensed with in writing by those entitled to share in the estate. In contrast, no bond is required of an executor, as the testator's confidence in the executor has been shown by the fact of the testator's appointment of the executor.

- (4) If the *executor* dies with a will, the executor's executor continues to administer the first estate. However, where the *administrator* dies with a will, his or her executor does not take over the first estate. Similarly, if an *executor or administrator* dies *without a will* the estate does not vest in his or her administrator. Where the duties of administering the estate have not been completed, it may therefore be necessary to appoint an administrator of the first estate. This second grant is called an administration *de bonis non*.
- (5) An executor is bound by the instructions set out in the will, whereas an administrator's duties are set out by law.

The legal personal representative holds any undistributed property as trustee (§9-755) — ie the legal interest in the property — after probate/administration. The beneficiaries have an equitable interest (§13-240) until the assets are distributed.

§3-730 Executors and administrators. The legal duties of the executor or administrator are to collect the assets of the estate, pay the debts of the estate (by selling or sometimes by leasing or mortgaging assets) and distribute the balance according to the will or the order set out in the legislation covering administration of intestate estates. The legal personal representative has various powers to ensure the proper management of the deceased estate. These include the power to employ agents such as solicitors and accountants to carry out professional work for the estate; the power of sale; the power to mortgage; the power to lease and the power to carry on a business while winding up the estate.

In exercising these powers, the representative is under a fiduciary duty to act in the interests of the estate and the beneficiaries (§9-770).

Other powers and duties include:

Payment of debts and liabilities. Having realised the assets of the estate, the representative pays debts — such as those under a registered child support order, or unpaid taxes — from assets (if the estate is solvent) or according to the priority rules of the *Bankruptcy Act 1966* (Cth) if the estate is insolvent (§13-720).

Some assets are not available for the payment of debts, including death benefits from life insurance or superannuation funds.²⁶

Distribution of estate by will. A gift of property in a will is generally called a bequest, though the technical name is a “devise” (for real estate: the

26. eg *Life Insurance Act 1995* (Cth) sec 205.

beneficiary is a “devisee”) or a “bequest” or “legacy” (for personal estate: the beneficiary is a “legatee”). A legacy may be “specific” (identifiable property, such as “my Nissan registration number 123 ABC”) or “general” (“\$5,000”). If the testator did not own Nissan registration number 123 ABC at death, the legacy is “adeemed” (ademption of legacy). If the net estate is insufficient to pay all legacies in full, the legacies are reduced or abated proportionately.

Distribution of intestate estate under Letters of Administration. Rules for the distribution of an intestate estate are set out in State legislation.²⁷ Typically those statutes provide for the widow or widower of the deceased to take a specified amount (which is updated from time to time to account for inflation) (or in some jurisdictions an entitlement to elect to obtain the matrimonial home if owned by the deceased spouse) with the residue to be distributed in specified proportions between widow or widower and children or other next of kin.

Rights of the legal personal representative. Like a trustee, the legal personal representative is entitled to an indemnity and reimbursement from the estate for expenses or liabilities incurred in administering the deceased estate. As a fiduciary, the representative cannot profit from the office of fiduciary. Exceptions to this include agreement by the beneficiaries, a court order, a gift to a representative, or where the representative is a trustee company which can be paid commission under the trustee companies legislation (§9-860).

Liabilities of the legal personal representative. The representative is personally liable for breach of fiduciary duty (§9-770); any contracts entered into on behalf of the estate; fraud; and failure to comply with the terms of the will or the intestacy legislation.

LEASES

Tenancies, leases and licences	§3-740
Types of leases and tenancies	§3-750
Contents of leases and tenancies	§3-760
Termination of leases and tenancies	§3-770

§3-740 Tenancies, leases and licences. A tenancy (or a lease or leasehold interest) is an interest in property under which a landowner or landlord (or lessor) gives a tenant (or lessee), usually in consideration of

27. *Wills, Probate and Administration Act 1898* (NSW); *Administration and Probate Act 1958* (Vic); *Succession Act 1981* (Qld); *Administration and Probate Act 1919* (SA); *Administration Act 1903* (WA); *Administration and Probate Act 1935* (Tas); *Administration and Probate Act 1929* (ACT); *Administration and Probate Act 1969* (NT). National uniform and

up-to-date laws in the area of family provision have been recommended by the National Committee for Uniform Succession Laws (established and coordinated by the QLRC) in its report presented to the Standing Committee of Attorneys-General, December 1997, noted (1998) 72 ALJ 249.

rental payments, the right to exclusive possession for a specified period of time. The landlord retains legal ownership of the property while the tenant has exclusive possession.

The lease is the document or agreement creating the tenancy; however, not all tenancies are by way of lease.

In contrast to a lease, and even though it may be over property, a licence given by the licensor only gives authority or permission to the licensee to enter, occupy or use the property (for example to run a franchise).²⁸ The rights given by a licence are personal to the licensee,²⁹ limited in use, and are not transferable or assignable to a third person and lack the proprietary element in the property which characterises a lease.

Despite this distinction, modern tenancy legislation, as well as statute law such as the *Trade Practices Act 1974* (Cth) and the common law, including the law of contract,³⁰ often applies to leases and licences, expressly or by implication.

¶3-750 Types of leases and tenancies. Leases and tenancies can be classified according to their features or how they are created:

- Fixed term tenancy or lease. This is usually written, and its duration for a fixed term must be certain or tied to definite events so that its duration is certain.³¹ It can usually be terminated early by notice or by the happening of a specific event.
- Periodic tenancy. A periodic tenancy is generally verbal and continues from one period to the next (eg monthly, weekly, yearly) until the tenancy is terminated. Many written residential leases provide for a periodic tenancy at the end of the fixed term if neither party terminates the lease.
- Tenancy at will or informal lease. A common law tenancy at will arises when one person is in possession as a tenant with the owner's consent, such as a tenant continuing in possession after the expiry of a lease for a fixed term where there is no provision in the lease for holding over. Legislation in some jurisdictions provides that informal leases are deemed to be tenancies coming to an end at the will of either party on one month's notice.³²
- Tenancy at sufferance. This tenancy arises by implication of law (not

28. eg *KJRR Pty Ltd v Commissioner of State Revenue* 99 ATC 4335 (agreement held a licence, not a lease), noted *Lease and licence — yet again* (1999) 73 ALJ 787.

29. Such as the right of the licensee or grantee of a licence to share amenities such as bathroom and kitchen in a boarding house.

30. eg Butt, P, *The contractualisation of leases: a further step?* (1996) 70 ALJ 97.

31. eg a lease "for the duration of the war" was held void as its maximum duration would not be certain: *Lace v Chandler* [1944] KB 368.

32. eg *Conveyancing Act 1919* (NSW) sec 127; *Property Law Act 1974* (Qld) sec 129; *Property Law Act 1969* (WA) sec 72.

by agreement) where a person has initially entered the land lawfully (eg as a tenant under a lease for a fixed term) but remains in possession after the lease has ended without statutory authority and without the assent or dissent of the landlord.

¶3-760 Contents of leases and tenancies. As with any other contract, a lease setting out the agreement between landlord and tenant is made up of numerous terms (¶6-010; ¶6-040). Some terms are expressly agreed to (¶6-050—¶6-090) and some are implied by statute and the common law (¶6-100—¶6-140). Residential leases are regulated in several jurisdictions, and their contents are limited by law.³³ Non-residential leases contain provisions and “covenants” (a promise by which the tenant undertakes that certain facts agreed to are true or by which the tenant undertakes to do or to refrain from doing certain things).³⁴

The following generalises the common contents³⁵ of a lease for regulated residential premises contrasted with a lease for other premises under Torrens title and under general law/old system title:

1. Fitness for habitation

Regulated residential leases	Tenancy in general
Duty of landlord to provide premises in reasonably clean condition at commencement of the tenancy, and duty of tenant to maintain premises in reasonably clean condition during the tenancy.	No duty of landlord to disclose to tenant defective state of repair or to maintain the premises. No implied warranty that the premises are habitable or legally fit for their purpose.

Minimum health, sanitation and safety requirements are imposed by housing and local government legislation. Cleaning is divided between landlord (before the lease) and tenant (during the lease).

2. Renovations, alterations, improvements

The tenant can only improve the premises if allowed by the lease under both residential and non-residential tenancies.

3. Fixtures

Permission to install fixtures (¶3-080—¶3-110) and fittings must be given by the landlord, and fixtures erected by the tenant for ornament or domestic purposes can be removed by the tenant.

33. eg *Residential Tenancies Act 1994* (Qld); 1995 (SA); 1997 (Vic); 1987 (NSW); 1987 (WA).

34. The word “covenant” is loosely used to refer to promises in a lease whether in a deed (¶5-040) or not. Building covenants

running with land (including those in leases) may infringe the *Trade Practices Act 1974* (Cth): ¶8-180.

35. Synonymous in this context with terms, obligations and covenants.

4. Repair and maintenance

Regulated residential leases	Tenancy in general
A statutory duty on landlord to repair and maintain the premises and common areas (eg lifts) in good condition. Tenant can enforce landlord’s maintenance obligations, carry out limited self-help repairs (sewerage blockage, gas and roof leaks, etc) and has right to vacate if premises have become unfit for human habitation.	<i>Caveat emptor</i> (let the buyer beware) for tenant. Heavy repair and maintenance obligations are often imposed on commercial tenants, such as keeping drains clear and not overloading floors or walls. May be an obligation on tenant to keep premises in good repair, except for allowance for fair wear and tear due to reasonable use of the premises.

5. Quiet enjoyment

Tenancy law gives the tenant no right to privacy as such, but residential tenancy legislation and the covenant for quiet enjoyment give the tenant a limited right to occupy the premises without unreasonable disturbance by the landlord or the landlord’s agents. Breaches of this right include interference with/removal/disconnection of services and physical parts of the premises (eg removal of doors, windows), interference with access, intimidation and persecution, physical interference (eg creating smells, dust, vibrations, etc) and damage to the leased premises. Landlords have the right to enter with notice to show the premises (to prospective buyers, prospective tenants, valuers and financiers), to repair, and to inspect.

6. Usual covenants — tenancy in general

The following covenants imposing obligations on the tenant are imputed by statute if not specified in detail or specifically excluded from the lease by the parties:

- to pay rent to the landlord;
- to maintain and leave the premises in good repair (having regard to their condition at the beginning of the lease and allowing for reasonable wear and tear);
- to allow the landlord to enter and view the state of repair, carry out requirements of public authorities, and repair under the lease;
- not to use or allow the premises to be used for any illegal purpose, or in such a manner as to cause a nuisance;
- not to assign or sublet the whole or part of the premises without the landlord’s consent. The landlord’s consent shall not be unreasonably withheld;
- to pay property rates and taxes. Power and phone charges are usually paid by the tenant. In commercial leases, the tenant usually pays all outgoings.

In particular, the landlord normally undertakes

- to give the tenant quiet possession of the property; and
- to repair the property.

Regulated residential leases	Tenancy in general
<ul style="list-style-type: none"> to pay a security deposit (previously, a bond) as security for payment of rent and performance of the tenant's obligations under the lease; bonds paid to agents must be deposited in their trust accounts (§11-430); an insurance option may be available under which the tenant pays the landlord an insurance premium to arrange insurance to cover the amount of the bond. 	<ul style="list-style-type: none"> (bonds are not usual in non-residential leases, although a bank guarantee or personal guarantee up to a specified amount as security may be agreed to); to insure from fire in the names of lessor and lessee; to paint inside and outside every [] years; to fence and to maintain fencing; not to carry on any offensive trade, business or occupation; to use the premises only as specified (eg restaurant, service station, etc).

§3-770 Termination of leases and tenancies. Termination of regulated residential leases and of tenancy in general are compared below:

Regulated residential leases	Tenancy in general
<p>Termination can take place by:</p> <ul style="list-style-type: none"> surrender of the lease or express agreement between parties; the tenant giving the landlord notice of intention to leave (not necessary if periodic or fixed period has expired) for reasons such as premises having become unsafe, unfit to live in, landlord's violation of tenant's privacy, landlord's failure to repair and maintain premises; the landlord giving signed and written notice of termination to the tenant if the tenant is in breach of the tenancy, eg for rental arrears or other default such as malicious damage. For example, the NSW Act specifies notices of 14 days (eg for unpaid rent), 30 days (if the landlord wishes to sell the property with vacant possession; not applicable to a lease for a fixed term) and 60 days (without the need to specify reasons; not applicable to a lease for a fixed term). 	<p>Any of the following causes ends the tenancy at the expiry date of the notice:</p> <ul style="list-style-type: none"> surrender of the lease or express agreement between parties. If the tenant relets the property and the landlord accepts rent under protest, there may still be no evidence of surrender; expiry of term/effluxion of time; notice to quit by the lessor or a notice of intention to quit by the lessee, the length depending on the length of the tenancy; repudiation by the tenant (such as abandonment of the property or failure to pay the rent). These are breaches of an essential term (§6-050—§6-090) of the lease; frustration of contract (impossibility of performance) (§6-350—§6-370);

Regulated residential leases	Tenancy in general
<ul style="list-style-type: none">● abandonment, but with the tenant liable to compensate the landlord for any losses arising; <p>Landlord/tenant disputes can be resolved in the Residential Tenancies Tribunal or similar (§7-730) or in the Small Claims Tribunal (§7-690—§7-720) with an absence of legal formality and at minimal cost to both parties. The Tribunal can declare rent or a rent increase to be excessive, authorise entry by the landlord, and order that work be carried out. It can make an order for termination of the agreement and for recovery of possession, eg if there is serious damage to the property.</p>	<ul style="list-style-type: none">● forfeiture. The landlord may re-enter the property and the lease may be forfeited if the tenant breaches a term of the lease such as the obligation to pay rent. The landlord must first serve notice specifying the breach. The tenant may have the right to apply to the court for relief against forfeiture and to revive the lease if the breach is removed.

Terminating a lease is like ending any other contract (§6-280ff). Therefore the full range of legal remedies is available to the landlord and tenant for breach of the lease, such as damages (§6-450) (eg for breach of covenant for quiet enjoyment), as well as equitable remedies such as an injunction (§6-410) (eg to restrain wrongful termination of the lease), specific performance (§6-400) (eg a covenant to make alterations), and declaratory orders (eg the meaning of lease covenants).

Chapter 4

Tort in the Business World

INTRODUCTION TO THE LAW OF TORT ...	¶4-010—¶4-050
NEGLIGENCE	¶4-060—¶4-170
DAMAGES	¶4-175—¶4-220
NEGLIGENT MIS-STATEMENT	¶4-230—¶4-295
CRIMINAL NEGLIGENCE	¶4-300

INTRODUCTION TO THE LAW OF TORT

Definition of a tort	¶4-010
Types of tort	¶4-020
Breach of contract distinguished from tort	¶4-040
Crime distinguished from tort	¶4-050

¶4-010 Definition of a tort. The word “tort” is taken from the French word meaning “wrong”.¹ The word tort in modern law now refers to conduct which is a civil wrong. In particular, a tort in the law refers to a breach of a duty, other than one arising under a contract, which gives rise to a civil cause of action in law and for which compensation may be recoverable. The wrongdoer — the person who commits the tort or tortious act — is called the tortfeasor.

¶4-020 Types of tort. The law of torts protects invasions of a person’s security of person or property.

Examples of torts include:

1. See ¶3-040 for a discussion of “law-French”.

- negligence, the tort detailed in this chapter from ¶4-060;
- nuisance, both public and private; this may result from, eg, gas, fumes, water, smoke, obstruction;
- trespass to the person such as assault, battery, false imprisonment;
- trespass to goods such as the torts of detinue and conversion:
 - conversion is wrongful and intentional interference with goods, including any tangible, movable property such as animals, title deeds and cheques (¶16-460);
 - detinue is wrongful detention of another person's goods where the plaintiff has requested the specific return of the goods and the defendant has refused (see, eg, ¶15-130).
- trespass to land; unauthorised entry upon private land is a trespass; there may be trespass above the land by entry into the airspace (¶3-120), and trespass below the surface (¶3-150); occupiers owe a duty of care to trespassers on the land, and may be sued by an injured trespasser for negligence (¶4-090);
- breach of statutory duty;
- deceit; a fraudulent misrepresentation which does not become part of a contract (¶5-700) may be litigated in the tort of deceit;
- passing off (¶12-030);
- defamation; defamation law protects a person's reputation from being unjustly injured. A person's reputation is protected by the common law in some jurisdictions and by legislation modifying the common law principles in New South Wales, Victoria, South Australia, Western Australia, the Northern Territory and the Australian Capital Territory.² Queensland and Tasmania have codified the defamation laws so that only the defamation legislation applies in those jurisdictions.³ Common law has no application in Queensland and Tasmania.
- interference with some domestic or economic relations; the industrial torts such as unlawful interference with trade or commerce;⁴ conspiracy. The separate tort formerly called the rule in *Rylands v Fletcher*, which imposed strict liability for the escape of dangerous substances, was absorbed into the law of negligence by the High Court in *Burnie Port Authority v General Jones*⁵ (¶4-090).

2. *Defamation Act 1974* (NSW); *Wrongs Act 1958* (Vic); *Wrongs Act 1936* (SA); *Criminal Code Act 1913* (WA) Chapter XXXV; *Defamation Act 1938* (NT); *Defamation Act 1901* (ACT).

3. *Defamation Act 1899* (Qld); *Defamation Act 1957* (Tas).

4. See, eg, *Dollar Sweets Pty Ltd v Federated Confectioners Association of Australia*

[1986] VR 383; (1985) Aust Torts Reports ¶80-755 where, for the purposes of awarding an injunction, a union picket line was sufficient evidence of the tort; later settled: "Dollar Sweets wins \$175,000 from union", *The Age*, 13 April 1988.

5. (1994) 179 CLR 520; (1994) Aust Torts Reports ¶81-264.

¶4-040 Breach of contract distinguished from tort. The parties to a contract have the right to have the promises of the other party or parties to the contract enforced by law, with the right to compensation for the consequences of the breach of promise. This right arises only because the contracting parties have intentionally agreed to incur mutual legal obligations (¶15-020).

In contrast, the law of torts protects the general rights of every individual which are conferred by law and not by other individuals. These general rights include rights not to have one's person, reputation, property and certain family, business and economic interests injured. The law of torts enforces the law's judgment depending on the relationship between the parties. The prerequisites for establishing a duty of care are discussed at ¶4-080. The existence of a contractual relationship may possess sufficient proximity to give rise to a tortious duty of care.

The threshold issue that often arises, when contracting parties litigate in respect of alleged obligations or duties that have not been expressed in the contract, is whether the action should be brought in tort or contract. If there is a common law duty of care which imposes the alleged obligation on one of the parties, then, as a matter of law, there can be no implied contractual obligation that is concurrent and co-extensive with that duty. If the duty already exists by virtue of tort law, it is not possible to presume that the parties intended that an identical term be part of the contract, and it is not necessary to incorporate the term into the contract to give the contract business efficacy. The tests for implying a term into a contract (¶16-110) are not satisfied.

¶4-050 Crime distinguished from tort. Crimes involve conduct of an anti-social nature which the state or government regards as justifying prosecution and punishment of the offender in order, for example, to keep the peace and deter affected and interested citizens from "taking the law into their own hands". For this reason criminal proceedings are conducted in the name of the state, whereas in tort the proceedings are brought by the injured party and conducted in that party's name.

To the extent that crimes involve interference with personal or proprietary interests, they may overlap the law of torts and give rise to personal or civil remedies. The law of torts, however, extends beyond crimes, identifying standards of behaviour which, although not criminal in themselves, are considered to be wrongful or unlawful because of the effect they have on the interests of another person.

NEGLIGENCE

The concept of negligence	¶4-060
Elements of an action in negligence	¶4-070
Establishing a duty of care	¶4-080
Recognised duties of care	¶4-090
The standard of care required	¶4-100
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Damage must be caused	¶4-125
Causation: remoteness	¶4-130
Only foreseeable damage recoverable	¶4-140
Proving negligence	¶4-150
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Voluntary assumption of risk	¶4-170

¶4-060 The concept of negligence. The tort of negligence is concerned with protection of person, property and economic interests from damage caused by another person's failure to take reasonable care. The law provides legal remedies (¶4-175) for injuries caused by negligence as defined:

"Actionable negligence consists in the neglect of the use of ordinary care or skill towards a person to whom the defendant owes the duty of observing ordinary care and skill, by which neglect the plaintiff, without contributory negligence on his part, has suffered injury to his person or property."⁶

"... negligence means more than heedless or careless conduct, whether in omission or commission: it properly connotes the complex concept of duty, breach, and damage thereby suffered by the person to whom the duty was owing."⁷

Negligence is the tort which has come to dominate twentieth century tort law following its classic formulation in the successful test case of *Donoghue v Stevenson* in 1932 involving the plaintiff's gastroenteritis after consuming the snail-in-the-bottle (¶1-350ff; ¶4-080).⁸

Certain negligence situations are now being litigated under consumer legislation contained in the *Trade Practices Act 1974* (Cth) (and the parallel *Sale of Goods Act* and *Fair Trading Act* of each State and Territory jurisdiction and the *ASIC Act 1989* (Cth)). Section 52 prohibits conduct which is "misleading or deceptive" (¶7-250ff). Sections 71 and 74 read into contracts for the supply of goods and services non-excludable conditions of quality and fitness for purpose (¶7-070—¶7-095).⁹

¶4-070 Elements of an action in negligence. The elements of an action in negligence are as follows:

6. *Heaven v Pender* (1883) 11 QBD 503 at p 507.

7. *Lochgelly Iron & Coal Co v M'Mullan* [1934] AC 1, per Lord Wright at p 25.

8. [1932] AC 562.

9. "*E*" v *Australian Red Cross Society* (1991) ATPR ¶41-085; (1992) ATPR ¶41-156, set out at ¶7-206, illustrates these parallel remedies and some of their strengths and weaknesses.

- (1) *A duty of care* — a duty owed by one person to another and based on the particular relationship, in fact, between the two parties and between the defendant and the relevant, foreseeable risk of injury (§4-080—§4-090).
- (2) *Standard of care* — a standard imposed by law which requires conformity with a certain standard of conduct for the protection of others against unreasonable risks (§4-100—§4-120).
- (3) *Damage* — a failure to conform with that required standard of conduct resulting in actual damage to the person to whom the duty of care was owed. The damage must have been caused or contributed to by the breach of the duty of care and must also have been a foreseeable consequence of that breach (§4-125—§4-140).

§4-080 Establishing a duty of care. To be liable for negligence in relation to another person, a person must owe a legal duty of care to that other person. Negligence according to law may not correspond to the ordinary meaning of negligence.

— *Case example* —

The snail in the bottle. Mrs Donoghue quenched her thirst in a café with a drink of ginger beer poured from an opaque bottle. When her glass was refilled, the decomposed remains of a snail slipped from the bottle. What happened next and further details of this case are set out at §1-350; §1-380.

_____ *Donoghue v Stevenson*¹⁰ _____

Whether a duty of care exists in a particular situation is a question of law and not fact: it is for the judge to decide, not the jury. There is no precise formula establishing when this duty of care is owed between persons, although historically the classic formulation of the “neighbour” test of Lord Atkin in *Donoghue v Stevenson* was used.¹¹

“Neighbour” test. “[I]n English law there must be, and is, some general conception of relations giving rise to a duty of care, of which the particular cases found in the books are but instances. The liability for negligence, whether you style it such or treat it as in other systems as a species of ‘culpa’, is no doubt based upon a general public sentiment of moral wrongdoing for which the offender must pay. But acts or omissions which any moral code would censure cannot in a practical world be treated so as to give a right to every person injured by them to demand relief. In this way rules of law arise which limit the range of complainants and the extent of their remedy. The rule that you are to love your neighbour becomes, in law, you must not injure your neighbour; and the lawyer’s question, Who is my neighbour? receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be — persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so

10. [1932] AC 562.

11. Ibid at p 580.

affected when I am directing my mind to the acts or omissions which are called in question.”¹²

As noted above, the determination of the existence of a duty of care is a question of law. But it is a question determined by reference to the particular facts of the individual case. All the circumstances of a particular case which have a bearing on the relationship, in fact, between the parties are considered in order to determine whether, as a question of law, a duty of care *should* be upheld. The consideration of the relationship between the parties extends to the particular risk of injury which eventuated, the defendant’s relationship to that risk and the nature of the damage suffered by the plaintiff, although no one factor, of itself, can decide the question.

Duty of care. A “duty of care” arises from the “proximity” of the relationship between the parties.

- “Foreseeability” alone is not sufficient to establish proximity giving rise to a duty of care:¹³ “The true question in each case is whether the particular defendant owed to the particular plaintiff a duty of care having the scope which is contended for, and whether he was in breach of that duty with consequent loss to the plaintiff. A relationship of proximity in Lord *Atkin*’s sense must exist before any duty of care can arise, but the scope of the duty must depend on all the circumstances of the case.”
- There must be proximity — physical, circumstantial or causal — to give rise to a duty to take reasonable care. The “proximity” or “neighbourhood” requirement is substantive and independent of foreseeability, deliberately and expressly introduced by the law to limit or control the bare test of reasonable foreseeability.
- Reasonable reliance is an important element of a duty of care. In addition, the defendant’s knowledge and control and the plaintiff’s vulnerability can point to a duty of care being owed.
- Charity and compassion do not constitute a duty of care, and there is no duty on a person to go to the aid of someone in peril or distress not caused by that person: “A man on the beach is not legally bound to plunge into the sea when he can foresee that a swimmer might drown.”¹⁴
- Where a person knows or should know that their acts or omissions

12. The neighbour doctrine is an example of what the late Professor Julius Stone called a “concealed circular reference” or “question-begging” — “we owe a duty of care when we ‘ought’ to take care”: Stone, J, *Precedent and Law: Dynamics of Common Law Growth*, Sydney, Butterworths, 1985, p 66.

13. *Governors of Peabody Donation Fund v Sir Lindsay Parkinson and Co Ltd* [1985] AC 210 at p 240; [1984] 3 All ER 529 at p 534.

14. *Council of the Shire of Sutherland v Heyman* (1985) 157 CLR 424, per Brennan J. In *Lowns v Woods* (1996) Aust Torts Reports ¶81-376, a relationship of proximity was found to exist between a doctor and a child notwithstanding the fact that the child had not previously been the doctor’s patient.

may cause the loss or impairment of the legal rights of another and that that person is not in a position to protect their own interests, there is a relationship of proximity giving rise to a duty of care.¹⁵

- Knowledge that the plaintiff may suffer economic loss is one factor which may establish the existence of a duty of care.¹⁶
- “The vulnerability of the plaintiff to harm from the defendant’s conduct is therefore ordinarily a prerequisite to imposing a duty [of care].”¹⁷
- Where a person who has power to direct or to control the actions of another person knows that there is a real risk of harm unless the direction is given with care, that person owes a duty to exercise the power with reasonable care for the other person’s safety.¹⁸

The ability to establish a duty of care in an increasingly wide variety of situations underlines the comment of Lord *Macmillan* in *Donoghue v Stevenson* to the effect that “[t]he categories of negligence are never closed”.¹⁹

¶4-090 Recognised duties of care. Proximity of relationship usually needs to be established before a duty of care will be held to exist.²⁰ However, where the facts of a particular case are similar to those in previously decided cases, a duty of care may be more easily established. The following relationships, among others, may give rise to a duty of care:

- (1) Professional persons, such as accountants, auditors and solicitors, are under a duty, owed to their clients, of reasonable competence as set by objectively analysed community standards (not by the prevailing standards of the particular profession). This is discussed further at ¶4-110—¶4-120, ¶4-230—¶4-295.
- (2) A negligent mis-statement or negligent advice may be actionable in tort if given by a person occupying a position requiring special skill or knowledge and the person to whom the statement was made acted upon it in circumstances where it was reasonable to do so, suffering loss as a result (¶4-230—¶4-290). This principle applies equally to bodies with statutory powers such as government authorities and local councils. Arguably, the principle should be extended so that when a body is given statutory powers for the purpose of protecting members of the public from harm, the body should be under a common law duty to take reasonable care to make effective use of those powers in order to achieve the body’s statutory purpose.

15. *Perre v Apand Pty Ltd* (1999) Aust Torts Reports ¶81-516 per *Gaudron J*; (1999) 73 ALJR 1190; ¶4-215.

16. *Ibid*, per *Gummow J*.

17. *Ibid*, per *McHugh J*.

18. *Crimmins v Stevedoring Industry Finance Committee* [1999] HCA 59; (1999) 74 ALJR 1.

19. [1932] AC 562 at p 639.

20. See *Gummow J* in *Hill v Van Erp* (1997) 188 CLR 159 at pp 237-238; (1997) Aust Torts Reports ¶81-418 at pp 63,939-63,940.

- (3) The driver of a motor vehicle owes a duty of care to the person and property of other users of the road, and the standard of care is that of the competent driver. No duty of care was owed by a drunk driver of a stolen car to his equally drunk passengers, who set out on a "joy ride" with the later intention of committing a few break and enter offences, because they could not reasonably have expected the driver to exercise reasonable care for their safety in the circumstances.²¹
- (4) The driver of an exempt or an emergency vehicle such as an ambulance, fire engine or police vehicle while on duty may disregard speed limits and traffic lights, and other vehicles are under an obligation to give way pursuant to statutory regulations. However, the law is not harsh on the ordinary motorist observing the normal rules of the road, and the exempt driver, who must still exercise care, may be found negligent.²²
- (5) Occupiers owe a duty of care to entrants in respect of dangerous premises because of their control over the premises.²³ Entrants include all those who enter the premises by express permission (eg guests), by implied permission (eg the postman), and even in some circumstances uninvited visitors such as trespassers (especially children and "innocent" trespassers).

— Case examples —

A farmer shooting to immobilise the car of a trespasser stealing petrol created a danger to occupants of the vehicle. The shooting occurred in darkness, with the thief standing beside the car, but the possibility that another person might be in the vehicle ought reasonably to have been foreseen by the farmer. The farmer was held liable in negligence to the thief's girlfriend who was hit by a bullet which penetrated the door while she was crouching on the front seat of the thief's car: "Firing bullets at a car in such circumstances is not merely extra-hazardous, it is ultra-hazardous".

— *Hacksaw v Shaw*²⁴ —

Bondi Beach. The local council was liable in damages to a 14-year-old surfer at Bondi Beach rendered quadriplegic after being hit by a hard (fibreglass) surfboard in the area between the flags where hard boards are prohibited, because there was only one inspector on duty (the other was at lunch) and the lone inspector was some 40 metres away from the flagged area at the time.

— *Glasheen v The Council of the Municipality of Waverley*²⁵ —

After leaving a nightclub after midnight, P trespassed on neighbouring premises by climbing a 1.8 metre fence to go to the toilet that she saw at

21. *Gala v Preston* (1991) 172 CLR 243; (1991) Aust Torts Reports ¶81-105. subject to reduction of compensation for each by 50% for contributory negligence).
22. *Patterson v McGinlay* (1991) 55 SASR 258; (1991) Aust Torts Reports ¶81-087 (police officer driving against the lights: plaintiff motorist and defendant police officer each successful in negligence
23. eg *Burnie Port Authority v General Jones Pty Ltd* (1994) 68 ALJR 331; ¶4-020.
24. (1984) 155 CLR 614, per *Murphy* J at p 630.
25. (1990) Aust Torts Reports ¶81-016.

the rear. When she attempted to flush the disused overhead concrete cistern in the dark, it fell on her and knocked her unconscious. P failed to establish a reasonably foreseeable risk of injury and D owed her no duty of care.

— *Bryant v Fawdon Pty Ltd*²⁶ —

The once recognised distinction between the restrictive and specialised rules applying to occupiers (formulated in 1883) has been incorporated into the general duty of care of the law of negligence.

— *Case examples* —

Safeway supermarket. A shopper (P) slipped on the vinyl tiled floor of the foyer area at a Safeway supermarket on a wet January Saturday morning. The High Court was “unable to see sufficient justification for continued recognition” of the restrictive English rules of occupier and invitee in the Australian common law, and held Safeway liable according to the ordinary law of negligence. Because P was a lawful entrant in the shop, Safeway owed P a duty of care to take reasonable care to avoid foreseeable risk of injury.

— *Australian Safeway Stores Pty Ltd v Zaluzna*²⁷ —

A swimmer dived off a rock ledge at the edge of a swimming area on Rottnest Island and hit his head on a submerged rock. The swimmer was successful against the local authority, and was able to establish that its failure to install a sign warning against diving into the ocean from a rock ledge was the cause of his injury.

— *Nagle v Rottnest Island Authority*²⁸ —

At about midnight and after drinking with friends, a 15-year-old girl (P) fell about seven metres from the top of a cliff at a coastal reserve managed by the Conservation Commission (D). Her injuries caused high level paraplegia. The High Court found that D was not in breach of its duty of care to P for failing to provide precautions necessary “to arrest the passage of an inattentive young woman affected by alcohol The entrant is only entitled to expect the measure of care appropriate to the nature of the land or premises entered and to the relationship which exists between the entrant and the occupier ... the occupier is generally entitled to assume that most entrants will take reasonable care for their own safety”.

— *Romeo v Conservation Commission of the Northern Territory*²⁹ —

- (6) Manufacturers owe a duty of care to consumers, as established in *Donoghue v Stevenson* itself (¶4-080; ¶7-208), *Grant's case* (¶7-090) and, more recently, *Thompson v Johnson and Johnson Pty Ltd*.³⁰

26. (1993) Aust Torts Reports ¶81-204 (Full Court, WA).

27. (1986) 162 CLR 479; (1987) Aust Torts Reports ¶80-073, noted (1987) 61 ALJ 245; *Kocis v SE Dickens Pty Ltd (t/as Coles New World Supermarket)* (1996) Aust Torts Reports ¶81-382.

28. (1993) 177 CLR 423; (1993) Aust Torts Reports ¶81-211 (High Court), noted, eg,

(1993) 23 UWAL Rev 320. *Brennan CJ*, in the minority in the *Nagle case*, took the same position in *Romeo* on the basis that it would place a public authority in the position of an insurer.

29. (1998) 72 ALJR 208, per Kirby J at p 234.

30. (1989) Aust Torts Reports ¶80-278.

- (7) Suppliers are under a duty of care with regard to dangerous things, such as firearms, chemicals and pharmaceuticals distributed to the public. This was also the basis of *Donoghue v Stevenson* (¶4-080) and *Grant's case* (¶7-090). This principle explains the sometimes elaborate containers used for the packaging of medicines and pharmaceuticals to prevent access by children; the current standard, however, is not one of tamperproof packaging that would prevent the activities of the unforeseen and unexpected criminal tamperer injecting consumer products with poisons, etc.³¹
- (8) Bailees of goods are under a duty of care while goods are in their possession (¶15-070—¶15-130). Bailment refers to a delivery of goods such as deposit for safe keeping, hiring, lending, carrying: the person giving is the bailor; the person receiving is the bailee. Carriers owe a duty of care in respect of their passengers and freight.
- (9) Builders are liable for negligence, but legislation in some jurisdictions restricts the liability of a builder, where another person would be jointly or severally liable, to the amount of the builder's own contribution.³² The builder's liability in negligence extends to later owners of the property who were not the building's original owner,³³ unless, for example, evidence shows that the original owner (and not the builder) had ultimate control of the building.³⁴

The flexibility of negligence is illustrated by the fact that social and community standards and expectations will be reflected in judgments; what constitutes reasonable care may thus expand to meet new and changing circumstances. The categories of negligence change in response to changing conditions and now include aerobics instructors/aerobics centres³⁵ and sports fixture operators.³⁶

Non-delegable duty of care

To the *Donoghue v Stevenson* duty of care to avoid a foreseeable risk of injury to another (¶4-080) can be added the *non-delegable duty of care*.

A non-delegable duty of care is a more stringent special responsibility to *ensure* that all reasonable care is taken. The non-delegable duty of care arises from the central element of control of the person owing the duty. It arises because "the person on whom it is imposed has undertaken the care,

31. Bass, MA and Wiesen, I, *Tylenol's aftermath: product liability implications* 69 American Bar Association Journal 287 (1983).

32. eg *Building Act 1993* (Vic) sec 129-134A; 1993 (NT) sec 155-162; *Development Act 1993* (SA) sec 72-73.

33. eg *Bryan v Maloney* (1995) 182 CLR 609; (1995) 69 ALJR 375; noted (1995) 69 ALJ 687; noted, eg, Ter, KL, *Builder's*

liability; a retreat from Murphy (1996) 17 Business Law Review 149.

34. As in *Woollabra Municipal Council v Sved* (1996) 40 NSWLR 101 (¶4-260) (builder not liable to later owner).

35. eg Lee, MW, *Issues in aerobics liability*, LSJ, Vol 34, No 1, p 40 (February 1996).

36. eg Sarre, R, *Spectator protection — the legal issues confronting sports fixture operators* (1995) 2 Canberra LR 25.

supervision or control of the person or property of another or is so placed in relation to that person or his property as to assume a particular responsibility for his or its safety, in circumstances where the person affected might reasonably expect that due care will be exercised.”³⁷

The non-delegable duty of care imposes a higher standard of care on the person owing it. That person must also ensure that reasonable skill and care is taken in relation to the functions it leaves to others to carry out for it, such as its independent contractors (¶11-020).

The non-delegable duty of care does not require personal performance and it cannot be discharged merely by employing a competent person to carry out the duty of care.

The following relationships give rise to the non-delegable duty to see that reasonable care is taken:

(1) Employers are under a non-delegable duty of care to their employees to provide a safe system of work. This general duty of care can be grouped into the following four categories:

- the duty to employ competent staff. An employer may be negligent in not dismissing an incompetent or dangerous employee;
- the duty to provide and maintain a safe place of work;
- the duty to provide and maintain safe plant and equipment;
- the duty to provide and maintain a safe system of work. System includes such things as the physical layout of the job, the sequence of operation, warnings, notices and instructions.

(2) A school authority (whether it be a government, church, independent school, etc) is under a non-delegable duty of care to take positive steps to maintain the safety of students.³⁸ This duty operates before and after actual teaching time, in the classroom and elsewhere on school premises, at sport and on excursions, and also applies to pre-school teachers and supervisors.

(3) Landlord and tenant.

— Case example —

The nine-year-old daughter of the tenant family was electrocuted when turning off an outside water tap and suffered severe brain damage which left her in a persistent vegetative state. The High Court found the landlord negligent for letting the premises in a dangerous condition. “The premises were unsafe by reason of a defect which would have been manifest on a simple inspection, namely, the lack of a connection between the major earth wire and the neutral link. That defect was easily remediable.” The landlord was liable for discoverable defects in the premises which existed at the

37. *Kondis v State Transport Authority* (1984) 154 CLR 672 at p 687.

38. eg *Watson v Haines* (1987) Aust Torts Reports ¶180-094 (\$2.2m awarded to 15-

year-old schoolboy rendered quadriplegic in school rugby league game); *ACT Schools Authority v El-Sheik* (2000) Aust Torts Reports ¶181-577.

commencement of the tenancy. It was in breach of its “non-delegable” duty of care (see below) owed to tenants and their families to ensure that the electrical system in the leased premises was in a safe condition because of their special dependence and vulnerability.

— *Northern Sandblasting Pty Ltd v Harris*³⁹ —

(4) Hospital and patient.⁴⁰

(5) Adjoining owners of land in relation to work threatening support or common walls.

(6) Occupier and invitee (arguably).

(7) strict liability for the escape of dangerous substances under the rule in *Rylands v Fletcher*⁴¹ This rule was absorbed into the law of negligence in the *Burnie case*:

— *Case example* —

The Burnie Port Authority (D) owned the building in which P stored frozen vegetables. D hired an independent contractor to instal extra electrical and refrigeration equipment in the building. While the independent contractor’s welders were working, sparks fell on cardboard cartons containing polystyrene which was to be used for insulation. The sparks set the building alight and P’s frozen vegetables were destroyed.

The High Court held that D owed P a non-delegable duty of care in respect of its property. D was under a duty of care to avoid a foreseeable risk of injury and this could not be discharged only by hiring a competent independent contractor. The danger in this case was sufficient to render any duty of care owed by D to P non-delegable because of D’s central element of control.

— *Burnie Port Authority v General Jones Pty Ltd*⁴² —

No duty of care

Not all accidents are caused by a breach of a duty of care giving rise to a claim in negligence:

39. (1997) Aust Torts Reports ¶81-435; (1997) 71 ALJR 1428, per Brennan CJ at p 64-256; p 1440.

40. *Albrighton v Royal Prince Alfred Hospital* [1980] 2 NSWLR 542.

41. (1866) LR 1 Ex 265; [1861-73] All ER Rep 1, aff’d (1868) LR 3 HL 330. This case established the modern doctrine of strict liability for the escape of dangerous substances: a “person who, for his own purposes, brings on his land, and collects and keeps there anything likely to do mischief if it escapes, must keep it in at his peril, and, if he does not do so, he is prima facie answerable for all the damage which is the natural consequence of its escape.”

42. (1994) 179 CLR 520 at p 556; (1994) Aust Torts Reports ¶81-264 at p 61,120, noted eg (1994) 68 ALJ 463. The “rule in *Rylands v Fletcher* ... should now be seen, for the purposes of the common law of this country, as absorbed by the principles of ordinary negligence. Under those principles, a person who takes advantage of his or her control of premises to introduce a dangerous substance, to carry on a dangerous activity, or to allow another to do one of those things, owes a duty of reasonable care to avoid a reasonably foreseeable risk of injury or damage to the person or property of another.”

— *Case example* —

Two rugby union players who had suffered spinal injuries were unsuccessful in suing the members of the International Rugby Football Board in London for negligence in their framing of the rules of the game which they alleged had exposed them to unnecessary risk. The players argued that the Board should have changed the rules of the game. The High Court held that:

- no duty of care arose between the Board members drafting rules and the hundreds of thousands of players playing under those rules. To hold each member of the Board liable to each player would be “so unreal as to border on the absurd” because they did not control the games in which the players were injured.
- to say that the members of the Board “owed a duty of care to (the players) would diminish the autonomy of all who choose ... to engage voluntarily in this, or any other, physically dangerous pastime.”
- “Separate questions may arise about school age children whose decisions are made or affected by others but those questions need not be considered in this case.”

*Agar v Hyde*⁴³

¶4-100 The standard of care required. The standard of care which must be observed in a particular situation is that standard which the ordinary, reasonable and prudent person would observe. The task of deciding what standard of care should be observed in the circumstances of a particular situation may not be easy:⁴⁴

“... it must be observed that in all cases the amount of care which a prudent man will take must vary infinitely according to circumstances. No prudent man in carrying a lighted candle through a powder magazine would fail to take more than if he was going through a damp cellar. The amount of care will be proportionate to the degree of risk run, and to the magnitude of the mischief that may be occasioned.”

All those facts which would influence the conduct of the reasonable person, and the reasonable person’s decision on the precautions to be taken, should be considered when deciding what standard of care should be observed in a particular situation. Such facts would include the foreseeable consequences of one’s actions and the seriousness of their effect on those to whom a duty of care is owed.

— *Case examples* —

The one-eyed motor mechanic. An employee at a council garage, who had lost the sight in one eye in an earlier injury while working under a motor vehicle, hit a rusted “U” bolt with a hammer to loosen it. This caused a

43. [2000] HCA 41 at para [67], [90] and [91]; (2000) Aust Torts Reports ¶81-569; ¶4-170. Both players, aged 18 and 19 at the time of their accidents, were hookers (playing in the middle of the front row of

the scrum) when their necks were broken by the crush from the opposing team.

44. *Mackintosh v Mackintosh* (1864) 2 Macph (Ct of Sess) 1357 at p 1362.

chip of metal to fly off and hit him in his good eye, blinding him. The employee succeeded against the employer in negligence and was awarded damages: the employer was under a duty to employees as individuals, and in this case this meant providing goggles and insisting they be worn. The test is: what precautions would the ordinary reasonable and prudent person take? The court confirmed that if an employer knows that an employee is suffering from a disability which increases the risk of serious injury if there is an accident, then that increased risk is relevant in determining what precautions the employer should take in fulfilling its duty of care to its employee. This is so even if the disability does not increase the risk that an accident will occur while the employee is working.

*Paris v Steptey Borough Council*⁴⁵ —

The cricket ball. During a home match between the Cheetham Cricket Club 2nd XI and Denton St Lawrence 2nd XI in Manchester, a cricket ball was hit for six by a Denton St Lawrence batsman and struck on the head Miss Bessie Stone who lived opposite the cricket ground and who had just stepped from her home on to the pavement. Miss Stone sued the committee and members of the Cheetham Cricket Club (but not the bowler except as part of the club, or the batsman) for damages for negligence. On the evidence it was foreseeable that someone on the road might be hit: a cricket ball had been hit out of the ground about six to ten times in the preceding 30 years but nobody had been hit. However, to hit a pedestrian, the ball had to pass over a two-metre fence (the top of the fence was about 15 metres above the level of the wicket because of the upward slope of the ground) and travel in all some 90 metres. The House of Lords decided that the risk of a ball actually striking someone on the road was so small that, in the circumstances, a reasonable person would have been justified in disregarding it. However, the court did not give cricketers legal immunity, as it made clear that if cricket cannot be played on a particular ground without creating substantial risk, it should not be played at all.

The Privy Council in a later case explained the effect of *Bolton v Stone* in the following terms:⁴⁶

“It does not follow that, no matter what the circumstances may be, it is justifiable to neglect a risk of such a small magnitude. A reasonable man would only neglect such a risk if he had some valid reason for doing so: eg, that it would involve considerable expense to eliminate the risk. He would weigh the risk against the difficulty of eliminating it ... In their Lordships’ judgment *Bolton v Stone* did not alter the general principle that a person must be regarded as negligent if he does not take steps to eliminate a risk which he knows or ought to know is a real risk and not a mere possibility which would never influence the mind of a reasonable man. What that decision did was to recognise and give effect to the qualification that it is justifiable not to take steps to eliminate a real risk if it is small and if the

45. [1951] AC 367.

46. In *Overseas Tankship (UK) Ltd v The Miller Steamship Co Pty Ltd (The Wagon Mound No 2)* [1967] 1 AC 617 at p 642.

circumstances are such that a reasonable man, careful of the safety of his neighbour, would think it right to neglect it.”

*Bolton v Stone*⁴⁷ —

The learner driver. A driving instructor (P) was injured when the learner driver (D) hit a concrete telegraph pole. D did not have a learner's permit, and it was unlawful for D to be driving. The High Court held that, in relation to the duty of care owed by the learner driver to the instructor, the standard of care was that of an inexperienced driver with limited knowledge of the controls of a motor vehicle; as far as other road users were concerned, however, the standard of care owed by a learner driver would generally be that which could reasonably be expected of a competent and experienced driver. The learner driver's conduct in accelerating, rather than slowing down or braking, to avoid a parked car fell below the standard of even an inexperienced driver. The High Court awarded damages to P for D's negligence, but reduced them by 70% for P's contributory negligence because P was aware of D's inexperience (§4-160).

*Cook v Cook*⁴⁸ —

The High Court of Australia set out factors to be considered in determining whether reasonable care has been taken in the following extract from a motor accident negligence action:⁴⁹

“... in determining whether a defendant's course of conduct involves any breach of that duty which he owes to others, there should be considered the risks inherent in that conduct, the seriousness of the consequences should any of those risks eventuate and the opportunities reasonably available to the defendant of reducing or wholly eliminating those risks. I should have thought that considerations such as these must undoubtedly, in almost every negligence case, enter, consciously or unconsciously, into the determination of the issue whether any breach of duty has occurred.”

The value of the activity is also a consideration; inherently dangerous activities, like driving a car on the highway, cannot be restricted for reasons of public policy. The standard of care expected of the reasonable person requires that account be taken of conduct on the part of others. The possibility that an employer's employee may act inadvertently or without taking reasonable care may give rise to a foreseeable risk of injury to a third person for which the employer may be liable in negligence.

Unlike the duty of care (§4-080), the question of what standard of care a person should observe in a particular situation is a question of fact and not law: where there is a trial by jury it is for the jury to determine, not the judge.

47. [1951] AC 850, discussed, eg, Scott, J, *Caught in Court — A selection of cases with cricketing connections*, London, Andre Deutsch, 1989, pp 227-231.

48. (1986) 162 CLR 376.

49. *Ryan v Fisher* (1977) 51 ALJR 125, per Stephen J at p 126.

¶4-110 Conformity with established standards. The standard of care is set by reference to community values assessed objectively, and conformity with established standards can assist in rebutting an allegation of negligence. The standard of care is an objective one; it is that of the reasonable person in the position of the defendant. Blood for transfusion was not screened for HIV in the early 1980s because medical research was inconclusive at that time (¶7-206). A learner driver is obliged to take the care expected of a competent and experienced driver for the safety of all road users (and anyone else who may foreseeably be affected by a failure to take that degree of care). In very exceptional circumstances, however, special knowledge on the part of the plaintiff may diminish the standard of care.

Failure to adopt the usual practice which others in similar circumstances adopt is generally evidence of failing to observe the standard of care which the reasonable person would observe. However, the mere fact that a person adopts the usual practice of others in similar circumstances does not necessarily demonstrate that the person has not been negligent, because the usual practice may be shown by the evidence to be itself negligent. For example, in *Paris v Stepney Borough Council* (see ¶4-100) the usual practice of employers was of little relevance to the question of what specific precautions a prudent employer would have taken for the safety of a one-eyed employee. The standard of care expected of medical practitioners is not the subjective test of what is done in the circumstances, but the objective test of what ought to be done, and should take into account what specialist qualifications the doctor has.

— *Case examples* —

When the driver of a Sydney tram proceeding down Cleveland Street, Redfern, collapsed at the controls, the tram failed to stop despite the efforts of the two conductors to apply the handbrakes. It collided at approximately 15 km/h with another tram on the same line, injuring the plaintiff passenger. The question to be decided was whether the tramways authority was negligent in failing to provide for the automatic stopping of a tram in the event of circumstances such as collapse of the driver. Evidence was tendered on behalf of the injured plaintiff regarding the “dead man’s handle” as used, for example, on Sydney’s electric trains. The use of this device had been rejected by the tramways authority as causing fatigue, irritation and inefficiency on the part of the driver, and “as a result of [the driver’s] relinquishing the pressure on the control, the tram became liable suddenly to diminish speed or stop, and in the denser parts of the traffic this made collisions from behind more probable” (*Dixon J* at p 599). It appeared that the Sydney trams were up to date in their equipment, were in line with the general practice of tramways, and that a “dead man’s handle” or any other automatic stopping device was not in use anywhere else on two-man trams. However, although the tramways authority clearly complied with established tramways standards, the High Court held the established standard itself to be negligent. The Chief Justice said (at p 589):

“The mere fact that a defendant follows common practice does not necessarily show that he is not negligent, though the general practice of prudent men is an important evidentiary fact. A common practice may be shown by evidence to be itself negligent. A jury is entitled, for example, on sufficient evidence, to find that a proper regard for the safety of other people would require the

adoption of some precaution which has only recently been discovered. But a jury is entitled so to find only if there is actual evidence to that effect.”

*Mercer v Commissioner for Road Transport
and Tramways (NSW)*⁵⁰ —

Sympathetic ophthalmia. Mrs P, who was almost blind in her right eye following a childhood injury some 40 years earlier, underwent surgery by Dr D, an ophthalmic surgeon, to improve the performance and appearance of the right eye. As a result of the surgery, which was carried out with skill and care, Mrs P lost the sight in her left eye due to a condition called sympathetic ophthalmia which developed after the surgery on her right eye. As a result, she was almost totally blind.

The High Court held that Dr D had breached his duty of care in advising the desirability of an operation on Mrs P's right eye by failing to inform her of a known but statistically very unlikely possibility (of 1:14,000) that the condition might lead to a condition causing blindness to the left eye. Although there was evidence of the practice among ophthalmic surgeons in similar circumstances not to mention the risk, the High Court held that the practice was not determinative and that the risk should have been disclosed.

The High Court set out the standard in this way:

“The standard of reasonable care and skill required is that of the ordinary skilled person exercising and professing to have that special skill, in this case the skill of an ophthalmic surgeon specializing in corneal and anterior segment surgery. As we have stated, the failure of the appellant to observe this standard ... consisted of the appellant's failure to acquaint the respondent with the danger of sympathetic ophthalmia as a possible result of the surgical procedure to be carried out”.

*Rogers v Whitaker*⁵¹ —

¶4-120 Changes in the standard of care. New methods, technological progress and the constant drive for improvement and modernisation suggest that what was up to standard yesterday may not be up to standard today.

— *Case example* —

It appears that railway authorities are at present under no obligation to prevent children from standing near an open door on a moving train or to provide automatically closing doors to prevent children from falling from a train, and that the sign “When Standing near Doorways Keep a Firm Hold” satisfies the duty of care owed to passengers.

*Maloney v Commissioner for Railways (NSW)*¹ —

50. (1936) 56 CLR 580.

51. (1992) 175 CLR 479 at p 483; discussed, eg, (1993) 67 ALJ 145; Duffy, J, *Information a reasonable patient expects*

to be told, Australian Optometry, Vol 14, No 9, p 12 (September 1993).

1. (1978) 52 ALJR 292.

The standard of care required of an auditor is that of the reasonably competent auditor acting in a reasonable manner. Professional standards do, however, change.

— *Case example* —

Pacific Acceptance Corporation Ltd, a finance company, claimed damages from Flack and Flack, its auditors, for losses caused by the auditors' failure to warn Pacific of fraudulent and irregular features in loans made to one Thompson and a group of companies with which he was associated. The auditors were found negligent and Pacific was awarded judgment of \$1.5 million damages.

— *Pacific Acceptance Corporation Ltd v Forsyth*² —

On the significance of changes in professional standards, *Moffitt J* stated that it was not a question of the court requiring higher standards because the profession had adopted higher standards. Rather, it was a question of the court applying the law which expected such reasonable standards as would meet the circumstances of today, including modern conditions of business and knowledge concerning them. Thus whoever ignores changes in professional standards or in business conditions — such as the failure by an engineer to keep abreast of technical developments on footing design and slab construction related to buildings to be erected on reactive and unstable soils — does so at their own risk.

¶4-125 Damage must be caused. The law of negligence compensates only actual damage (¶4-175ff). Damage may be economic (¶4-215), or it may be damage to property or to the person (such as the physical illness of Mrs Donoghue after drinking the contaminated ginger beer: ¶1-350). Embarrassment or loss of dignity may be seen to aggravate general damages for pain and suffering but will not, alone, give rise to a cause of action, but psychiatric damage (including “nervous shock”) may be compensated. For example, when Constable Allan Coffey was seriously injured in a road accident while on duty on his motorcycle, Mrs Coffey suffered psychiatric illness after the news of the accident, what she was told at the hospital (that he was “pretty bad”) and her fear (apparently well founded) that he might die.³

¶4-130 Causation: remoteness. There must be some causal connection between the breach of duty of care and the damage suffered. Causation is a difficult issue, as the breach may be only one of a number of causes which contributed to that damage. In the words of *Spigelman CJ*,

2. (1970) 92 WN (NSW) 29; ¶9-550.

3. *Jaensch v Coffey* (1984) 155 CLR 549; (1984) Aust Torts Reports ¶80-300, noted (1985) 59 ALJ 44; no recovery for psychiatric injury: *Annetts v Australian*

Stations Pty Ltd (2000) Aust Torts Reports ¶81-564 (connection between nervous shock of parents on learning of the death of their 16-year-old jackaroo son in the outback too remote).

“Causation, like any other fact, can be established by a process of inference which combines primary facts like ‘strands in a cable’ rather than ‘links in a chain’.”⁴

— *Case examples* —

A person was hospitalised following a work-related injury to his head. Due to a pre-existing brittle bones condition, he fractured his leg while in hospital, adding to his period of hospitalisation and his expenses. The High Court held that the employer was not liable for the injuries received in hospital:

“[T]he head injury brings the man into a hospital; the hospital happens to have stairs; the man happens to have bones that can be broken by walking down stairs without stumbling or falling; then the surgeon considers that the time has come when his convalescence would be advanced by his walking in the grounds; to get to the grounds he walks down stairs and in doing so breaks his brittle bones Thus you produce the conclusion that a disability consisting in a broken leg amounts to a total incapacity for work resulting from a head injury sustained two months earlier.

“The simple answer appears to me to be that the broken leg was a distinct and separate injury due to a distinct and separate casualty or accident and that the fact that it occurred in conditions which would not have existed but for the sustaining of the earlier injury does not make it ‘result’ from the first injury.”

— *Lindeman Ltd v Colvin*⁵ —

A worker took a job as a painter. He suffered from epileptic fits and had been forbidden by his doctor to work at any height above the ground. He did not reveal his medical condition to the employer for fear of not being employed. While working on a platform six metres above the ground, he had an epileptic fit and fell to his death. The platform on which he was working did not comply with the statutory safety regulations and therefore the employer was in breach of his statutory duty. In deciding whether the employer’s fault in not providing a platform with guard rails or the employee’s fault in not revealing his medical condition to his employer was the cause of death or whether they were both causes, *Denning LJ* said (at p 407):

“... causation is, I think, a question of fact. If you can say that the damage would not have happened but for a particular fault, then that fault is in fact a cause of the damage; but if you can say that the damage would have happened just the same, fault or no fault, then the fault is not a cause of the damage. It often happens that each of the parties at fault can truly say to the other: ‘But for your fault, it would not have happened.’ In such a case both faults are in fact causes of the damage.”

The court concluded that the employee’s death was caused equally by the fault of the employer and the fault of the employee.

— *Cork v Kirby MacLean Ltd*⁶ —

4. *Seltsam Pty Ltd v McGuiness* [2000] NSWCA 29; (2000) Aust Torts Reports ¶81-547 at para [91].

5. (1946) 74 CLR 313, per *Dixon J* at p 320.

6. [1952] 2 All ER 402.

The “but for” test, applied as a negative criterion of causation, is important in determining causation. However, it is not the exclusive test of causation in negligence cases. It excludes from liability in negligence conduct that causes something which would have happened anyway. In addition the “but for” test should be read with a second test of whether the defendant is in law responsible for the damage caused by the negligence. In other words, irrelevant “but fors” will be excluded in determining causation as this second test involves considerations of policy and the application of accepted value judgments.⁷

For example,

- was the cause of Cambridge Credit’s collapse the auditor’s negligence (but for it, the company would have been wound up in 1971 instead of trading until 1974), or
- was it other factors during this period of continued trading, such as the collapse of a land boom, a downturn in the Australian economy and poor management decisions on behalf of the company? The New South Wales Court of Appeal upheld these other causes (¶4-260).

— *Case example* —

A young woman aged 17, injured in a car accident, was offered heroin as a painkiller by one of her hospital visitors and on his third visit accepted it “because of the pain”. She became addicted to heroin, and the need for \$900 per day for heroin eventually devoured all her money as well as that of her mother. In an action for damages against the driver for personal injury, \$25,000 of the general damages award of \$45,000 was awarded for heroin addiction and subsequent degradation caused by the accident. This award for heroin-based general damages was reversed on appeal because of the plaintiff’s failure to establish a causal link between the driver’s breach of duty and her heroin addiction.

Yates v Jones⁸ —

Applying the so-called “but for” test helps to solve a question like this. The law says that the driver’s fault would be the cause of the plaintiff’s damage if the harm would not have occurred without (but for) it. In other words, the driver’s conduct could not be the cause if the damage (the addiction) would have happened anyway. The plaintiff failed to establish on the balance of probabilities that the driver’s negligence had caused the addiction.

— *Case examples* —

Surgeon’s failure to warn. Following an operation by Dr D on Mrs P’s oesophagus, Mrs P suffered damage including voice loss. Evidence showed that she was concerned about the possible risks, and that she had said to

7. *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506; see also, eg, *Medlin v State Government Insurance Commission* (1995) 69 ALJR 118 at p 121.

8. (1990) Aust Torts Reports ¶81-009.

Dr D that "I don't want to wind up like Neville Wran." Causation was established, and the court awarded damages of \$173,000.

The High Court stated its approach to causation in these words:

"In *March*^[9] this Court specifically rejected the 'but for' test as the exclusive test of factual causation. Instead the Court preferred the same common sense view of causation which it had expressed in its decision in *Fitzgerald v Penn*.^[10] There, the Court said that the question is to be determined by asking 'whether a particular act or omission ... can fairly and properly be considered a cause of the accident'. As a natural consequence of the rejection of the 'but for' test as the sole determinant of causation, the Court has refused to regard the concept of remoteness of damage as the appropriate mechanism for determining the extent to which policy considerations should limit the consequences of causation-in-fact.^[11] Consequently, value judgments and policy as well as our 'experience of the "constant conjunction" or "regular sequence" of pairs of events in nature'^[12] are regarded as central to the common law's conception of causation."

— *Chappel v Hart*¹³ —

The valuation of a residential property in Hunters Hill in Sydney carried out for a bank by D, a real estate valuer, was held to be negligent. As a result of the valuation, the bank advanced a loan to the owner secured by a mortgage, and P (a mortgage insurer) insured the mortgage over the property. When the owner defaulted on the loan, the bank sold the property under its power of sale (¶13-045) for an amount less than the valuation and claimed its loss from P. The High Court held D (the valuer) liable for the loss suffered by P. The facts were held to satisfy the "but for" test. The facts also satisfied the tests in *Chappel v Hart* (above) because the negligence of D "was directly productive of the making of the insurance contract [by P] ... had the valuation been a correct one, there would have been no loss suffered by [P] as it would not have provided the mortgage insurance at all."

— *Kenny & Good Pty Ltd v MGICA (1992) Ltd*¹⁴ —

¶4-140 Only foreseeable damage recoverable. Having established a duty of care, breach of that duty, and damage caused by that breach, is a tortfeasor liable for all the damage suffered? The answer is no:

— *Case examples* —

Wagon Mound No 1. Shipbuilders and engineers (P) owned a wharf in Sydney Harbour. D had chartered a ship, the *SS Wagon Mound*, which

9. *March v Stramare (E & MH) Pty Ltd* (1991) 171 CLR 506.

10. (1954) 91 CLR 268 at p 276.

11. *Bennett v Minister of Community Welfare* (1992) 176 CLR 408 at pp 412-413.

12. Hart and Honoré, *Causation in the Law*, 2nd ed, 1985, at p 14.

13. (1998) 72 ALJR 1344 at p 1349, noted Clarke, J, *Causation in Chappel v Hart: Common sense or coincidence?* (1999) 6 JLM 335.

14. (1999) 73 ALJR 901, per Kirby and Callinan JJ at p 924. The valuer was also held to be in breach of *Trade Practices Act 1974* (Cth) sec 52: ¶7-280.

was moored at a nearby wharf about 200 metres away. Due to carelessness of employees of D, oil had spilled onto the surface of the harbour. Sparks from P's welding ignited the floating oil, and P's wharf was damaged. P was unsuccessful in its claim for negligence against D:

"... it does not seem consonant with current ideas of justice or morality that, for an act of negligence, however slight or venial, which results in some trivial foreseeable damage, the actor should be liable for all consequences, however unforeseeable and however grave ..."

The test to be applied in determining for what damage compensation can be recovered is whether the damage is of such a kind as the reasonable man would have foreseen. P did not fulfil this test as P was unable to prove that a reasonable person in the position of D would have foreseen the real risk of fire from the oil spill.

— *Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound No 1)*¹⁵ —

Wagon Mound No 2. This oil spill gave rise to a second case — this time brought by the owner of a ship moored at the wharf which was also damaged by the fire (P2). In this second case, P2 was successful because it was able to prove that the defendant was aware that there was a real risk due to the oil spill. This case decided how foreseeable the damage must be to be recoverable. Namely, if the risk of damage is a real one which would occur to the mind of a reasonable person in the tortfeasor's situation and one which the person would not brush aside as far-fetched, then such damage would be reasonably foreseeable and the tortfeasor would be liable to pay compensation for it.

— *Overseas Tankship (UK) Ltd v The Miller Steamship Co Pty Ltd (The Wagon Mound No 2)*¹⁶ —

¶4-150 Proving negligence. It is the function of the judge to decide whether the evidence has established any facts from which negligence may be inferred. If the judge is of the opinion that negligence may be inferred from the evidence and there is a jury, it is for the jury to decide whether that evidence is credible and, if so, whether it does in fact establish negligence.

The burden of proof is on the person who has suffered damage to establish on the evidence that:

- (a) the person was owed a duty of care,
- (b) the required standard of care was breached, and
- (c) the breach caused the damage which was of a kind that was a foreseeable consequence of the breach.

The standard of proof required is the normal civil standard of proof on the balance of probabilities, compared to the criminal standard of "beyond reasonable doubt".

15. [1961] AC 388 at p 422; [1961] 1 All ER 404 at p 413.

16. [1967] 1 AC 617, background in Park, M, *Jean who?* (1991) 65 LJ 1026.

The expression or maxim *res ipsa loquitur* (the thing speaks for itself) is an attempt to deal with circumstantial evidence — it refers to a fact from which it is permissible to infer negligence if the fact is unexplained. The expression does not alter the principle that the burden of proof is on the party who has suffered damage to prove negligence. The High Court has been critical of the expression with the reminder that it is not a rule of law and that it is no more than an aid to logical reasoning by inference. For example, if an injured employee cannot prove negligence by the employer, the employee cannot rely on *res ipsa loquitur*.¹⁷ The maxim does not alter the principle that the burden of proof is on the person who has suffered damage to prove negligence.

¶4-160 Contributory negligence. At common law no compensation could be recovered where a person suffered damage partly through the person's own negligence and partly through the negligence of another. However, statute law throughout Australia now provides for the apportionment of damage in such a situation.¹⁸ For example, in South Australia sec 27A(3) of the *Wrongs Act 1936* provides:

"Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage ..."

Thus, where A negligently drives into and injures B, who negligently stepped off the footpath in front of A's car, B can still sue for damages. If the court is prepared to award B damages of \$120,000, but holds that B was one quarter to blame for his injury, the award would be reduced to \$90,000.

A statutory reduction for contributory negligence is based on a factual finding that the plaintiff and the defendant are both to blame for the plaintiff's injuries. There will be some cases, however, where a finding that one party caused the plaintiff's injuries will exclude a finding that the other party also caused the injuries.

— Case examples —

P, aged 15, was hit by a train while crossing the track at Perth's Loch Street Station. The evidence was not clear whether P had used the level crossing, and because P's crossing of the track was in the circumstances considered

17. *Schellenberg v Tunnel Holdings Pty Ltd* [2000] HCA 18; (2000) Aust Torts Reports ¶81-553; (2000) 74 ALJR 743, where the High Court noted that the maxim has been abolished by the Supreme Court of Canada.

18. *Wrongs Act 1936* (SA) sec 27A(3); *Law Reform (Contributory Negligence and*

Tortfeasors' Contribution) Act 1947 (WA) sec 4; *Law Reform Act 1995* (Qld) sec 10; *Wrongs Act 1954* (Tas) sec 4; *Law Reform (MP) Act 1955* (ACT) sec 15; *Law Reform (MP) Act 1956* (NT) sec 16; *Wrongs Act 1958* (Vic) sec 26; *Law Reform (Miscellaneous Provisions) Act 1965* (NSW) sec 10.

careless, contributory negligence was apportioned so that the railways were found 80% responsible for the accident and P 20% responsible.

*Connors v The Western Australian Government Railways Commission*¹⁹ —

A client who successfully sues its solicitor for negligent advice may have its damages reduced for its own contributory negligence providing the cause of action is framed in negligence only. The client may have been negligent in failing to properly assess the commercial soundness of the proposed venture upon which the solicitor advised. As the cause of action was framed in contract as well as tort, the High Court held that damages could not be reduced for contributory negligence.

*Astley v Austrust Ltd*²⁰ —

To be “contributory” the negligence must be causally connected with the damage suffered. Contributory negligence may comprise either a failure to take reasonable care of one’s own safety or a breach of a duty to the party being sued. Simple inadvertence is not evidence of contributory negligence, and all the circumstances have to be taken into consideration. The burden of proof in establishing contributory negligence is on the party who is alleging it.

Apportioning damages is for the jury (where the case is heard by a judge and jury) or by the judge where sitting without a jury. Apportionment is a matter of reduction of damages by the proportion which it is believed the injured party negligently contributed to the injuries. Appellate courts very rarely interfere with jury apportionments, and the judge’s power to award costs is not reduced by the jury’s power to apportion. Judges are not bound to apportion costs in the same ratio as the damages.

Contributory negligence has not normally been a defence for breach of contract; see ¶6-475 and *Astley v Austrust* above.

¶4-170 Voluntary assumption of risk. Unlike the partial defence of contributory negligence, the defence of voluntary assumption of risk (or consent) is a total defence. It is based on the assumption that a person cannot complain of damage which results from a risk which that person consented to run. For example, compensation for injuries received after voluntarily accepting a lift with a drunk driver²¹ has been held not to be recoverable, on the basis of voluntary assumption of risk. Use of pre-release or experimental computer software may constitute voluntary assumption of risk. A participant in a sporting event voluntarily assumes only the risks inherent in the sport and, for example, an experienced apprentice jockey does not consent to another jockey overtaking on the outside of the field and then cutting back

19. (1992) Aust Torts Reports ¶81-187 (Full Court, WA).

20. (1999) 73 ALJR 403, noted (1999) 73 ALJ 541; Masel, G and Kelly, D, *Contributory*

negligence and the provision of services: a critique of Astley (2000) 74 ALJ 306.

21. eg *The Insurance Commissioner v Joyce* (1948) 77 CLR 39.

in front of the other horses, compressing them against the rail and causing a fall.²²

To be an effective defence the consent must therefore be to the full risk of injury. Mere knowledge of the risk of injury is not considered to be sufficient to constitute consent, for the same reasons as a duty of care may require a defendant to do more than merely warn the plaintiff of the danger.

Voluntary participation in a sport does not necessarily imply a voluntary assumption of risk which would negate the existence of a duty of care by players and others involved in the sport such as officials.²³

DAMAGES

Remedies in tort	¶4-175
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¶4-175 Remedies in tort. The basic remedy in tort is an award of damages as compensation, on the assumption that restitution is often impossible to achieve (¶4-180ff). However, in some situations — such as the torts of trespass (¶3-120; ¶4-090) or nuisance — equitable remedies such as the injunction (¶6-410) may be appropriate to restrain the continuing offence.

¶4-180 Purpose of an award of damages. Fair compensation rather than punishment or retribution is the primary purpose of an award of damages; savings made by the plaintiff (such as domestic expenses while in hospital when damages are for personal injury) may be deducted from a damages award. The common law award of damages for personal injury does not provide for an indexed pension (as in some other countries) and is based on the “once and for all” rule.²⁴

A damages award is designed to place plaintiff P in the position in which P would have been had the tort not been committed, including allowance for expenditure incurred in reliance on defendant D’s conduct (reliance loss). For example, for breach of a non-contractual representation sued in the tort of deceit, the measure of damages is the difference at the time of the purchase between the real value of the goods and the price paid, and the consequential loss directly flowing from reliance on D’s representation. Assessment of

22. *Frazer v Johnston* (1990) 21 NSWLR 89.

23. *Agar v Hyde* [2000] HCA 41 at para [14]; (2000) Aust Torts Reports ¶81-569; ¶4-090.

24. *Fetter v Beale* (1701) 1 Salk 11; 91 ER 1122.

damages may be based on prediction and the hypothetical may be conjectured.²⁵

In contrast, damages are awarded in contract to place P in the position P would have been in had the contract been performed (§6-380).²⁶ For example, for breach of warranty in contract, P can recover the difference between the real value of the goods and the value of the goods as warranted.

¶4-190 Damages for property damage. The compensation principle governing damages is often easier to apply to claims for property damage than to claims for personal injuries. Indemnity is the key principle. This means that the plaintiff whose old car had been “written off” by the defendant’s negligence could only claim its replacement value. If the “old” car were in fact a priceless and unique vintage car the plaintiff would still be entitled to its replacement value. Indeed, determining the replacement cost of a unique object can present a court with some tricky analytical and factual problems.

Only the person with ownership of or an interest in the items at the time they were damaged can sue for damages for property damage. For example, where the plaintiff company had sold a cotton picking machine to a subsidiary in whose possession the machine was damaged by the defendant, the plaintiff’s claim for economic loss (§4-215) was rejected on the basis that property in the machine had passed to the subsidiary.²⁷

Consequential loss is also recoverable in the case of damage to or destruction of a profit-generating object such as machinery. Such consequential loss takes the form of economic loss rather than property damage, and if suffered by someone other than the owner of the property (eg someone whom the owner has permitted to use the property) may be recoverable under the ordinary principles of negligence governing recovery for economic loss (see §4-215). Losses consequential upon property damage can be insured against (§17-050).

¶4-200 Exceptions to the compensation principle. The plaintiff can only recover damages for injuries which are linked to the tortious conduct of the defendant by an unbroken chain of causation and which are foreseeable (§4-130—§4-140).

25. *Malec v JC Hutton Pty Ltd* (1990) 169 CLR 638; (1990) 64 ALJR 316, noted at (1990) 64 ALJ 601 (impossible to conclude that it was 100% certain that P’s back condition would have made him unemployable if he had not contracted a disease during his employment which made him unemployable); applied in *Poseidon Ltd v Adelaide Petroleum NL* (1994) 68 ALJR 313 in assessing damages for breach of the *Trade Practices Act 1974* (Cth) sec 52: ¶8-840.

26. Damages for breach of most sections of Pt IV or V of the *Trade Practices Act 1974* (Cth) are usually if not always assessed under the tort measure: ¶8-840.

27. *RG and TJ Anderson Pty Ltd v Chamberlain John Deere Pty Ltd* (1988) 15 NSWLR 363; (1989) Aust Torts Reports ¶80-240.

Moreover, the plaintiff is under a legal duty to minimise or mitigate the degree of injury caused by the defendant,²⁸ and failure to do so can lead to the plaintiff being awarded less than full compensation.

Nominal damages. In some cases a plaintiff may recover damages which provide less than full compensation. For example, a plaintiff may receive nominal (or contemptuous) damages. These damages involve the award of a token amount, such as \$1, and may be awarded by a judge or jury in a case where the plaintiff established that the defendant committed a technical breach of a legal right (such as the tort of nuisance) but where, in the opinion of the judge or jury, the plaintiff should not have brought the action because there was no compensable damage. Nominal damages may only be awarded in actions which are actionable without proof of damage, such as libel (ie written defamation). They cannot be awarded in negligence actions because damage is an essential element of a negligence action; if there is no damage, there is no action in negligence.

Aggravated damages. Aggravated damages may be awarded where a plaintiff's injury has been made worse by conduct of the defendant. Aggravated damages may be awarded if the defendant's conduct has caused injury to the plaintiff's feelings by insult, humiliation or the like. For example, in the case of defamation, aggravated damages may be awarded if the defamer fails or refuses to apologise or retract, or raises the defence of justification (ie that the defamatory matter was true) but fails to establish it. Aggravated damages are strictly compensatory, and are sometimes referred to as "aggravated compensatory damages" to distinguish them from exemplary damages.

Exemplary damages. Exemplary damages are punitive in nature and, despite the comments in ¶4-180, aim to achieve retribution and act as a deterrent.²⁹ A plaintiff may receive exemplary damages where the defendant has acted in a "high-handed, insolent, vindictive or malicious" manner or "had in some other way exhibited a contumelious disregard of the plaintiff's rights".³⁰ For example:

- exemplary damages were awarded to a miner negligently injured by exposure to asbestos in the Wittenoom mine in Western Australia;³¹
- exemplary damages were awarded after a medical practitioner who had been responsible for inseminating the plaintiff with the wrong sperm in an artificial insemination by donor program (AID) issued the plaintiff with threats and wrongly advised her to have an abortion.³²

28. *Smajic v Bonic* (1968) 88 WN (Pt 1) (NSW) 588, unreasonable for plaintiff to refuse to mitigate his damage — by refusing to undergo brain surgery which would have no deleterious effect if unsuccessful.

29. *Uren v John Fairfax and Sons Pty Ltd* (1965-1966) 117 CLR 118 at pp 138-139, 149.

30. *Uren's case* (1965-1966) 117 CLR 118, per Taylor J at p 129; Collis, BW, "Tort and punishment" — *exemplary damages: the Australian experience* (1996) 70 ALJ 47; ¶6-460.

31. eg *Midalco Pty Ltd v Rabenalt* [1989] VR 461 (exemplary damages of \$250,000).

32. *Backwell v "AAA"* [1997] 1 VR 182; (1996) Aust Torts Reports ¶81-387.

If a wrongdoer has already been punished by the criminal law, exemplary damages will not be awarded in an action based on the same facts.³³

Exemplary damages designed to achieve retribution are generally not awarded for breach of contract (§6-450) or for breaches of Part V of the *Trade Practices Act 1974* (Cth) and other State legislation including the *Defamation Act 1974* (NSW) (§8-840).³⁴

¶4-210 Damages for personal injury. Damages in personal injury actions comprise compensation for pecuniary and non-pecuniary loss. Pecuniary loss can be estimated in money terms (even though this may be speculative and uncertain) and includes:

- loss of earning capacity;
- medical expenses (eg hospital, physiotherapy);
- rehabilitation expenses (eg wheelchairs);
- personal care including gratuitous care.

Non-pecuniary loss, which is hard to assess in money terms, includes:

- pain and suffering;
- loss of amenities, such as the inability to enjoy normal activities as a result, for example, of loss of limb;
- loss of faculty, such as permanent unconsciousness.

The cost of domestic help and child care is a private expense not incurred in the earning of income and will not be included in a damages award: “In a sense, child care can be regarded as an opportunity cost”.³⁵

More recent authority suggests that damages may be awarded for the inability of injured plaintiffs to care for their children.³⁶

¶4-215 Liability for economic loss. The duty of care establishing negligence depends upon proximity, foreseeability and considerations of public policy (§4-080). Recognising that the “categories of negligence are never closed”,³⁷ and building on Lord *Atkin*’s neighbour formulation (§4-080), the law of negligence has in Australia since 1977 allowed recovery of damages for pure economic loss, that is, loss where there is no damage to person or property and no resulting physical damage, outside the category of *Hedley Byrne* (see §4-240). The latest leading case setting out the parameters to be set in cases of economic loss is *Perre v Apand Pty Ltd* (see §4-080).³⁸ Although so many of the leading cases are

33. *Gray v Motor Accident Commission* (1998) 73 ALJR 45, noted (1999) 73 ALJ 402; (1999) Aust Torts Reports ¶81-494.

34. Exemplary damages can be awarded in Federal Court representative actions: ¶7-780.

35. *Wynn v NSW Insurance Ministerial Corporation* (1996) 184 CLR 485 at p 495.

36. eg *Sullivan v Gordon* (1999) Aust Torts Reports ¶81-524.

37. *Donoghue v Stevenson* [1932] AC 562 at p 639.

38. (1999) Aust Torts Reports ¶81-516.

hedged about by qualifications, and by the peculiarities of their own facts, it is suggested that **there are four distinct economic loss situations:**

1. *Economic loss to the plaintiff as a result of physical damage suffered whether to the plaintiff's person or property.* Such economic loss, following a breach of duty of care, entitles the plaintiff to be put, in monetary terms, in the same position as if the negligence had not occurred. Compensation is generally recoverable where the plaintiff's economic loss is directly attributable to negligent damage to the plaintiff's own property. The authority of the "power-cut" cases,³⁹ which allowed damages for resulting loss of production or loss of profits because of being consequential upon physical damage, but which denied damages for pure economic loss, must now be taken to be weakened by the cases discussed below where recovery was allowed because the damage was both reasonably foreseeable and a direct consequence of the negligence in question.
2. *Economic loss to the plaintiff as the result of physical damage to person or property suffered by a third party.* Loss of the companionship of a wife (and in some jurisdictions a husband) or the services of a person (such as a child or employee) wrongfully injured has traditionally been actionable in the law of tort.

In the following cases, the plaintiffs (Caltex; Perre) were able to recover damages for pure economic loss without having suffered any physical injury.

— Case examples —

While deepening a channel in Botany Bay, the dredge "Willemstad" damaged pipelines used for carrying oil from the Kurnell Refinery (on the southern shore) to the Banksmeadow oil terminal (on the northern shore); the damage was extensive. Caltex Oil sued both the owner of the dredge "Willemstad" and the company responsible for plotting the path to be followed by the dredge, for damages in negligence. The Australian Oil Refining Pty Ltd, which owned the pipeline and carried the risk, also sued. The claim of Caltex was for damages for economic loss, namely, expenses caused by the loss of the means of obtaining processed petroleum at its terminal. These expenses included the cost of alternative road and sea transport to the terminal. This claim was rejected at first instance, but the decision on the question of economic loss was reversed unanimously by the High Court. Each of the five judgments raises important issues:

Gibbs J considered that this was an exceptional case where the defendant knew that the plaintiff individually, and not merely as a member of an unascertained class, would be likely to suffer economic loss as a result of its negligence. Having established proximity, liability then rested on foreseeability. The defendant should have foreseen economic loss to the plaintiff if the pipeline were damaged, because of the defendant's knowledge of its position and function. *Stephen J*, concurring, stated that foreseeability in itself was insufficient as a "control mechanism" and that proximity was

39. *SCM (United Kingdom) Ltd v WG Whittall & Son Ltd* [1971] 1 QB 337;

Spartan Steel and Alloys Ltd v Martin & Co (Contractors) Ltd [1973] QB 27; [1972] 3 All ER 557.

also necessary, which in this case was established by the common adventure of the plaintiff and the third party and by the knowledge of the defendant. *Mason J* allowed recovery for economic loss because of the defendant's knowledge of the precise purpose of the pipeline, and the fact that it should have foreseen the expenses that would be incurred if the pipeline were severed. *Jacobs J* upheld the defendant's duty of care, and considered that the plaintiff's inability to use the pipeline was equivalent to physical harm and therefore allowed recovery on accepted principles. *Murphy J* built on *Donoghue v Stevenson*, applied it to modern social and corporate responsibility and considered that "[i]f a negligent act results in great damage, there is no reason why the loss should be left with the victim because an individual or corporate wrongdoer is unable to pay fully for it. Where the state (or one of its agencies) is liable, social considerations may require limitation of liability".

*Caltex Oil (Australia) Pty Ltd v The Dredge "Willemstad"*⁴⁰

Bacterial wilt. D provided potato seed to a potato grower in the South Australian Riverland to grow an experimental crop for D to purchase to make into potato crisps. The seed was "non-certified" and came from a source in Victoria where there was the possibility that it might have been infected with a disease called bacterial wilt. The seed produced a crop which was found to be infected with bacterial wilt.

Action by one grower against D was successful in negligence and for breach of implied conditions of the contract under the sale of goods legislation (¶7-070-¶7-090). Damages of \$51,000 were awarded by the trial judge.

Due to quarantine laws, the neighbours of the grower (P) were unable to export their potatoes interstate because they had been grown within 20 km of the known outbreak. The neighbours were successful in their claim in the High Court for damages for pure economic loss.⁴¹ (They could not sue D in contract as they had no contract with D, and they could not sue for damages for negligence for physical loss as their land or tangible assets were not damaged.) The court held that D was in breach of its duty of care to prevent economic loss to the neighbouring potato growers (P) when it supplied the non-certified at-risk seed to the potato grower. Physical harm is not a pre-condition to liability in negligence for economic loss. There was evidence of foresight in the internal communications of D concerning the likelihood that neighbours might be harmfully affected. The court was not concerned about exposing D to "indeterminate" liability, as liability was limited by the physical closeness of P's land, the known vulnerability of persons in P's position and the control exercised by D over the potato grower's land.

*Perre v Apand Pty Ltd*⁴²

These cases confirm that a person can claim damages for economic loss without having to show injury to person or property.

40. (1976) 136 CLR 529 at p 606; (1977) 51 ALJR 270 at p 299.

41. Also called commercial loss or financial loss.

42. (1999) Aust Torts Reports ¶81-516; (1999) 73 ALJR 1190, noted (2000) 74 ALJ 17, 91; ¶4-080.

3. *Economic loss actionable by the plaintiff caused by a defective product with no injury to person or property.* Recovery for economic loss is allowed where it is established that a duty of care is owed to person or property. Recovery is also available to a person able to avert a foreseeable injury:

— *Case example* —

Negligence: damages for “pure economic loss”

A factory floor consisting of a magnesium oxychloride composition was mixed and laid in the plaintiff's factory by the defendant, a flooring subcontractor under contract to the plaintiff's builder. Two years later, and as a result of poor mixing and laying by the defendant, the floor started cracking over its surface presenting the plaintiff with the choice between ongoing high costs of continual maintenance or the lower cost of replacement of the floor. The latter choice was made and a claim for some £200,000 against the defendant for damages for physical and consequential economic loss was recognised by the House of Lords as being actionable.

— *Junior Books Ltd v Veitchi Co Ltd*⁴³ —

This case made new law in England because of the absence of any physical injury to the plaintiff or the likelihood of any. No damage had been caused to anything beyond the defective product itself, but because of the sufficient relationship of proximity between plaintiff and defendant, and the lack of any considerations limiting the scope of the duty of care, the judges held in favour of the plaintiff. The defence raised on behalf of the subcontractor was that in the absence of a contract with the plaintiff, the plaintiff's claim imposed warranties of fitness into a non-contractual relationship with the result that a plaintiff in a case like *Donoghue v Stevenson* would be able to recover damages for personal injury and — which was new — damages for the diminished value of the offending bottle of ginger-beer. Do the principles in this case apply to products, negligently manufactured, which are not harmful but are useless, or worthless, or defective in quality so that the purchaser's money has been wasted in buying them?⁴⁴ If cash settlement had been made between the plaintiff and the defendant subcontractor, and if the factory with its defective floor fixed temporarily was sold by the plaintiff to an unsuspecting purchaser, could that purchaser, upon discovery of the condition of the floor, also sue the subcontractor in negligence? The potential for further judicial initiative now appears wide.

4. *Economic loss actionable by the plaintiff following negligent statements which may or may not be accompanied by damage to person and/or property.* A person giving information or advice is under a duty to use reasonable care when that person knows or ought to know that the recipient may or will act

43. [1983] 1 AC 520; [1982] 3 All ER 201; noted (1982) 56 ALJ 663.

44. This issue was raised by Lord Keith in the *Junior Books* case at p 207 with a negative answer in the absence of “a duty

to take reasonable care to avoid acts or omissions which [a defendant] ought to have known would be likely to cause [a plaintiff] not only physical damage to person or property but also pure economic loss” (p 206).

on it (§14-230—§14-260), and damages for tort (and for breach of contract) are assessed as at the date of the breach.

For example, prospective beneficiaries under a will have successfully recovered damages in negligence against solicitors who were negligent in the drafting or execution of the will such that the intended gift to the beneficiary was invalid.

— *Case example* —

Solicitors had handled the affairs of client Mrs B for some time, and had drafted her will. When Mrs B died, the solicitors handled the affairs of her estate. However, they did not notify the executor (who was also the principal beneficiary) of her will until more than six years following her death. The executor had been left a house in the will, and over the six years the house had become run down and furniture and furnishings had been stolen. When the estate was eventually administered, the executor/ beneficiary P sued the solicitors in negligence, claiming his loss as the depreciation in value of the house. P also claimed loss of financial benefits of either rent-free accommodation over the period or of renting out the house. The High Court stated that a solicitor having custody of a will knows precisely who the beneficiaries are; and the value of the gifts to them (ie the maximum value of the damage that could be suffered as a result of the solicitor's negligence) can usually be ascertained. These considerations, along with a number of considerations of public policy, were sufficient to establish a duty founded in contract or tort to locate and inform the executor on learning of the testator's death.

— *Hawkins v Clayton*⁴⁵ —

Non-recovery for economic loss before 1976. The neighbour formulation of *Donoghue v Stevenson* (§14-080) was limited by case law to the existence of danger of physical injury to persons and their property, and it required the property to be not the same property giving rise to the danger of physical damage concerned. For policy reasons some categories of economic loss had been denied remedies. The policy reasons included:

- the floodgates argument: while it would be possible to limit the liability of a wrongdoer for physical damage it would be harder to limit liability for economic loss.
- the economic effects of negligence: these may be almost unbounded.
- the nature of negligent mis-statement: there is no possibility of recall as there is with a defective product, and the speed of transmission of a statement may result in almost instantaneous, as well as widespread, economic loss.
- the rules of contract: matters such as intention to enter into a legal relationship (§15-050ff) and privity (§16-260ff) act as control devices, which should not be overridden by an uncontrolled right in tort to recover for economic loss.

45. (1988) 164 CLR 539; (1988) Aust Torts Reports ¶80-163, noted Riley, F, *Holding a client's will? Consider the duty of care*

(1988) 10 LSB 259; *Hill v Van Erp* (1997) 71 ALJR 487.

¶4-220 **Accident compensation schemes.** Accident compensation is the main purpose of the remedies provided by the law of negligence, but it can be expensive to achieve and unsatisfactory in operation. Complicated and expensive legal proceedings raise the issue of whether tort has a future as a means of compensation.⁴⁶ Against the background of calls to preserve “common law rights”, compensation in addition to or as an alternative to remedies in negligence may be available under the following statutory provisions:

- workers’ compensation (¶17-065);
- criminal injuries compensation (¶1-160);
- social security;
- no-fault motor accident benefits in Victoria, Tasmania and the Northern Territory (¶7-730; ¶17-050);
- sporting injuries in New South Wales under the *Sporting Injuries Insurance Act 1978* (NSW).

Because losses incurred may exceed the limits of compensation available under statute, and because of the variations in compensation available for the same injuries from jurisdiction to jurisdiction, proposals have been advanced from time to time for a national compensation scheme along the lines of similar schemes in other countries.⁴⁷

NEGLIGENT MIS-STATEMENT

The concept	¶4-230
Responsibility of advisers	¶4-240
The “special relationship” concept	¶4-250
Professional responsibility widened in scope	¶4-260
Vicarious liability of employer	¶4-270
Guidelines to assist in avoiding negligent mis-statement	¶4-280
Accountants’ and auditors’ liability to unidentified members of the public	¶4-290
Negligent mis-statement under the <i>Trade Practices Act</i>	¶4-295

¶4-230 **The concept.** It is only in recent years that the tort of negligence has been applied by the courts in the business context with regard to the written, printed or spoken word of an adviser. The law had been reluctant to liken the written or spoken word to “a gun or other dangerous instrument”¹ and, fearing the opening of the floodgates, had refused claims

46. Fleming, JG, *Is there a future for tort?* (1984) 58 ALJ 131; *Criticisms of the American system of tortious liability* (1986) 60 ALJ 542.

167; Murphy, GA, *The case against no-fault accident compensation* (1985) 15 QLSJ 317.

47. See, eg, Luntz, H, *The case for no-fault accident compensation* (1985) 15 QLSJ

1. *Le Lievre v Gould* [1893] 1 QB 491 at p 502.

for negligent mis-statement unless a contractual or fiduciary relationship could be demonstrated.

The position changed with *Hedley Byrne & Co Ltd v Heller and Partners Ltd* (¶4-240) and is now that where advice given is to be relied upon, it does not take much to show that a duty of care, according to ordinary negligence concepts, goes with it. This means that any person with a "special" skill is under a duty to take care with the accuracy of advice or information. The adviser's duty is not merely to use care in any written report; it also extends to the use of care in the spoken word.

Just as the traditional concept of negligence covered both positive acts and failures to act (or omissions), the duty of advisers covers not only careless statements, but also the failure to disclose information that should have been disclosed.²

The traditional reluctance to award damages in such situations is illustrated in the *Ultramares case*, one of the pioneer cases in this area:

— Case example —

The defendants, a firm of public accountants, were employed to prepare and certify a balance sheet showing the state of the business of Fred Stern & Co Inc, a rubber import company, as at 31 December 1923. This company borrowed large amounts from banks and other lenders to finance its operations. The accountants knew that the balance sheet when certified would be shown to banks, creditors, stockholders, purchasers and sellers as the basis of financial dealings. Indeed, when the balance sheet was made up, 32 copies were supplied and certified with serial numbers as counterpart originals. The balance sheet showed assets of some \$2.5m, liabilities of some \$1.5m and a net worth of the company of \$1m, but in reality capital and surplus had been wiped out and the corporation was insolvent. Yet the auditor's certificate read:

"We have examined the accounts of Fred Stern & Co Inc, for the year ending December 31, 1923, and hereby certify that the annexed balance sheet is in accordance therewith and with the information and explanations given us. We further certify that, subject to provision for federal taxes on income, the said statement, in our opinion, presents a true and correct view of the financial condition of Fred Stern & Co Inc, as at December 31, 1923."

— *Ultramares Corporation v Touche*³ —

Could the auditors face liability for their inaccurate certificate? The plaintiff was approached by Stern in 1924 with a request for loans of money to finance the sales of rubber; and the supply of a certified balance sheet was

2. *Hawkins v Clayton* (1988) 164 CLR 539; (1988) Aust Torts Reports ¶80-163; ¶4-215.

3. 255 NY Rep 170; 174 NE 441 (1931), approved by the House of Lords in *Caparo Industries Plc v Dickman* [1990]

2 WLR 358; [1990] BCC 164 (see ¶4-290). Contrast *Glanzer v Shepard* 135 NE 275 (1922), where liability was imposed on giver of certificate because giver knew who was going to rely on it and the extent of that reliance.

one condition of the finance contract between the parties by which the plaintiff agreed to advance three unsecured sums of \$100,000, \$25,000 and \$40,000. What could the plaintiff do? There was no real point in queuing up as a creditor in the company's liquidation as any likely dividend would be small, so action in negligence and fraud was commenced against the auditors.

The real problem facing the court was the question of where to draw the line. The trial judge instructed the jury that the auditors might be held liable if, with knowledge that the results of the audit would be communicated to creditors, they did the work without reasonable and ordinary care, ie negligently. A verdict was found in favour of the plaintiff of \$188,000 (this was in 1931) which was, however, overturned on appeal. That is not to say that the principle was lost: it was held that, in the circumstances at hand, no negligence could be shown because of the absence of "privity" between the plaintiff and the accountants. After all, the plaintiff was not a client of the accountants, and the court was not prepared to hold accountants liable to any reliant third person (which in effect would have given a free ride to non-paying parties).

To have extended liability to third parties not in privity with the accountants would arguably have placed an enormous burden on the accounting profession, perhaps not justified by a corresponding increase in public benefit. Such open liability was dismissed as exposing accountants to "an indeterminate amount for an indeterminate time to an indeterminate class". This is discussed further at ¶4-290.

¶4-240 Responsibility of advisers. Recovery for economic loss caused by negligently given advice in tort is a fairly recent development.

— Case example —

Mr Candler invested £200 in a company on the strength of false accounts given to him by the company's auditor. His action in tort failed on the basis of lack of a contractual or a fiduciary relationship, even though the circumstances indicated very plainly that Mr Candler was, to the knowledge of the auditors, relying on their special skill as accountants to make a reliable report on the company's position.

— *Candler v Crane, Christmas & Co*⁴ —

That was in 1951 and the majority judges were not prepared to extend tort recovery to economic loss caused by negligence (as opposed to fraudulent misrepresentation). It may have been the prospect of the huge liability which could be imposed on all professional advisers which influenced the majority judges. The dissenting judgment of *Denning LJ* (as he then was) is of greatest significance today, for it was his view which was upheld by the House of Lords 13 years later in *Hedley Byrne & Co Ltd v Heller and Partners Ltd* (below). He agreed with the statement of *Cardozo CJ* in the *Ultramares* case

4. [1951] 2 KB 164; [1951] 1 All ER 426.

that to make an accountant liable to any person relying on the accounts would expose the accountant to "... liability in an indeterminate amount for an indeterminate time to an indeterminate class".⁵ Lord *Denning* concluded that the law would fail to serve the community if it should hold that accountants and auditors owe a duty to no one but their client. He saw it as removing a duty of verification from the accountant if the accountant could just rely on information received without having to give a personal opinion, and this Lord *Denning* was not prepared to accept:

"... The accountant, who certifies the accounts of his client, is always called on to express his personal opinion as to whether the accounts exhibit a true and fair view of his client's affairs; and he is required to do this, not so much for the satisfaction of his own client, but more for the guidance of shareholders, investors, revenue authorities, and others who may have to rely on the accounts in serious matters of business. If we should decide this case in favour of the accountants there will be no reason why accountants should ever verify the word of one man in a one man company, because there will be no one to complain about it ... [if this were the case] the accountant's certificate, which should be a safeguard, becomes a snare for those who rely upon it. I do not myself think that is the law."

Lord *Denning* concluded by upholding the duty of care of accountants not only to their own clients but to all those who to their knowledge will rely upon their accounts in the transaction for which those accounts are prepared. However, this was not the decision in the case, as the majority held that there was no liability on the basis of the absence of any contractual or fiduciary relationship. Its importance lies in its vindication in the *Hedley Byrne* case:

— Case example —

Hedley Byrne & Co were advertising agents who had placed substantial forward advertising orders for another company, Easipower Ltd, under which they (Hedley Byrne) would be personally liable for the cost of the orders. They asked their bankers, the National Provincial Bank Ltd, to make inquiries on the question of Easipower's financial stability and whether it would be good for an advertising contract of £8,000 to £9,000. The bank in turn made inquiries of Heller and Partners who were Easipower's bankers. Heller and Partners replied in a letter headed:

"CONFIDENTIAL

For your private use and without responsibility on the part of this bank or its officials ...

In reply to your inquiring letter of 7th instant we beg to advise

Re Easipower Ltd

Respectably constituted company, considered good for its ordinary business engagements. Your figures are larger than we are accustomed to see."

5. 255 NY Rep 170; 174 NE 441 (1931) at p 444.

In reliance on this reference, Hedley Byrne & Co placed orders for £17,662 which they lost when Easipower went into liquidation. Whom could they sue? They could queue with the other creditors in Easipower's liquidation (and wait for a dividend of possibly one per cent), or sue the bankers for breach of duty of care in negligence for the careless misrepresentation. This was the course chosen and the decision of the House of Lords firmly established the tort of negligent mis-statement, although on the facts of the case the merchant bank was found *not* liable because of its disclaimer of liability in the letter.

_____ *Hedley Byrne & Co Ltd v Heller and Partners Ltd*⁶ —

*In Hedley Byrne, a duty of care was stated to arise when:*⁷

“... in a sphere in which a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful inquiry, a person takes it upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise.”

Negligence and exclusion clauses. Negligence law interprets exclusion clauses strictly (¶6-240): an exclusion clause only excludes negligence if it unequivocally says so (and if legal under various statutes).⁸ An exclusion clause in general terms which excludes liability for contract and matters other than negligence cannot be relied on to exclude liability for negligence.⁹

Reliance on advice containing a disclaimer of liability against unknown third parties (“This report is for the use of the party to whom it is addressed and for no other purpose, and no responsibility is accepted to any third party for the whole or part of the contents of this report”) could raise the defence of voluntary assumption of risk (¶4-170), although the courts will give effect to such clauses only if their intended scope is clearly and precisely defined.¹⁰ If there is evidence of reliance, advisers' liability will depend on whether such reliance was reasonable as to give rise to a duty of care.

Duty of care: proximity and the reliance test. Proximity forms part of the duty of care concept, and proximity limits foreseeability as the test of the duty of care. In relation to proximity and foreseeability, the High Court recognises the importance of reliance as a test of negligent mis-statement: “When the economic loss results from negligent misstatement, the element of reliance plays a prominent part in the ascertainment of a relationship of

6. [1964] AC 465; [1963] 2 All ER 575.

7. Ibid at AC p 503; All ER p 594.

8. See ¶7-120; ¶7-170—¶7-205; ¶7-281; ¶7-370. Such disclaimer may itself constitute misleading or deceptive conduct under *Trade Practices Act* sec 52 or *Fair Trading Act* equivalents (¶7-250; ¶7-281).

9. *Graham v The Royal National Agricultural and Industrial Association of*

Queensland [1989] 1 Qd R 624; (1989) Aust Torts Reports ¶80-239.

10. eg *BT Australia Ltd v Raine & Horne Pty Ltd* [1983] 3 NSWLR 221. Such disclaimer may in any case fail or may itself constitute misleading or deceptive conduct. See further Jackson, J, *Tortious disclaimers and negligent misstatement: reasonableness and unconscionability* (1991) 65 ALJ 507.

proximity between the plaintiff and the defendant, and therefore in the ascertainment of a duty of care. But when the economic loss results from a negligent act or omission outside the realm of negligent misstatement, the element of reliance may not be present.”¹¹

¶4-250 The “special relationship” concept. The House of Lords in *Hedley Byrne* (¶4-240 above) held that a negligent though honest misrepresentation may give rise to an action for damages for any economic loss caused even though there may be no contractual or fiduciary relationship between the parties. The judges, with their reliance on notions of proximity, strongly suggested that they were merely applying the *Donoghue v Stevenson* (¶4-080) doctrine and that they were not introducing a new category of potential liability to an indeterminate class of person.

Two factors made the situation different from an ordinary negligence case:

- (1) the damage resulted from the written word, not physical action; and
- (2) the damage caused was purely pecuniary or economic, not physical damage to persons or property (¶4-215).

The cause of action was held to depend on the existence of a “special relationship” between the parties, and this concept was no more than an application of the “who is my neighbour?” principle of *Donoghue v Stevenson* — after all, as was said in that case, the categories of negligence are never closed (see ¶4-060—¶4-080).

The special relationship was said to exist:

“... where it is plain that the party seeking information or advice was trusting the other to exercise such a degree of care as the circumstances required, where it was reasonable for him to do that, and where the other gave the information or advice when he knew or ought to have known that the inquirer was relying on him ... A reasonable man, knowing that he was being trusted or that his skill and judgment were being relied on, would, I think, have three courses open to him. He could keep silent or decline to give the information or advice sought: or he could give an answer with a clear qualification that he accepted no responsibility for it or that it was given without that reflection or inquiry which a careful answer would require: or he could simply answer without any such qualification. If he chooses to adopt the last course he must, I think, be held to have accepted some responsibility for his answer being given carefully, or to have accepted a relationship with the inquirer which requires him to exercise such care as the circumstances require.”¹²

11. *San Sebastian Pty Ltd v Minister Administering the Environmental Planning and Assessment Act 1979* (1986) 162 CLR 340 at p 355; similarly, *Shaddock's case* (¶4-260).

12. [1964] AC 465; [1963] 2 All ER 575, per Lord Reid at AC p 486, All ER p 583.

The different judges took a variety of approaches to the test of whether reliance on statements was foreseeable; but the concept of the special relationship was established beyond doubt. *Candler v Crane, Christmas & Co* (¶4-240) was clearly overruled and Lord Denning's judgment in that case was approved.

The *Hedley Byrne* principle has been extended to include negligent mis-statements in relation to economic loss suffered as a result of medical treatment.¹³

¶4-260 Professional responsibility widened in scope. The features of a "special relationship" where the law will impose a duty of care were confirmed in *MLC Assurance Co Ltd v Evatt*:

— Case example —

MLC Assurance Co Ltd and HG Palmer (Consolidated) Ltd were both subsidiaries of the MLC Ltd. A policy holder of the former sought advice on the investment performance of HG Palmer. This advice was offered by an "officer" of MLC Assurance Co Ltd. (his or their identities are never made clear but his actions were sufficient to bind his employer, MLC Assurance (see ¶4-270)) that HG Palmer would continue to be financially stable and that it would be safe to invest further in it. On this advice, the policy holder invested further. When HG Palmer went into liquidation, the policy holder lost both his investment and interest thereon and sought damages in negligence from either MLC Assurance or the MLC Ltd or both. Three appeal courts and 13 judges later, the policy holder's appeal to the Privy Council was narrowly lost¹⁴ on the basis that MLC Assurance's business did not include giving advice on investments and that it did not claim to have the necessary skill and competence to give such advice and to exercise the necessary diligence to give reliable advice. Indeed, it was held that the only duty on the assurance company in these circumstances was to give an honest answer to a question clearly lying outside its sphere of operations. This was done and no liability could be imposed.

— *MLC Assurance Co Ltd v Evatt*¹⁵ —

The High Court test in *Evatt's case* was formulated by *Barwick* CJ, but the view of the High Court was rejected by a majority of the Privy Council. The importance of the High Court view, as upheld by the Privy Council minority, now lies in its application by the High Court in *Shaddock's case*¹⁶ in 1981, set out below. The test as formulated by *Barwick* CJ reads as follows:

- (1) The circumstances must be such as to have caused the speaker or be calculated to cause the speaker to realise that the speaker is being trusted

13. *Macfarlane v Tayside Health Board* [2000] AC 59.

14. In policy holder's favour: Court of Appeal 2:1; High Court 3:2; Privy Council 2:3.

15. [1967] 2 NSW 465 (NSW Court of Appeal); (1968) 122 CLR 556 (High

Court); (1970) 122 CLR 628, [1971] AC 793 (Privy Council).

16. *L Shaddock & Associates Pty Ltd v Parramatta City Council* (1981) 150 CLR 225.

by the recipient of the information or advice to give information which the recipient believes the speaker to possess or to which the recipient believes the speaker to have access.

- (2) The subject matter of the information or advice must be of a business or serious nature.
- (3) The speaker must realise or the circumstances must be such that the speaker ought to have realised that the recipient intended to act upon the information or advice.
- (4) The circumstances must be such that it is reasonable in all the circumstances for the recipient to seek, or to accept, and to rely upon the utterance of the speaker.¹⁷

These tests considerably broaden the scope of the duty of care by removing a number of the limitations that had been thought to be present in *Hedley Byrne*. In particular, where *Barwick* CJ noted that the special relationship can apply even where the speaker does not profess to possess in fact actual skill or judgment, its scope was left applicable to any situation of reliance.

The test was stated in the *San Sebastian* case as follows:¹⁸

“The maker of a statement may come under a duty to take care through a combination of circumstances or in various ways, in the absence of a request by the recipient. The author, though volunteering information or advice, may be known to possess, or profess to possess, skill and competence in the area which is the subject of the communication. He may warrant the correctness of what he says or assume responsibility for its correctness. He may invite the recipient to act on the basis of the information or advice, or intend to induce the recipient to act in a particular way. He may actually have an interest in the recipient so acting.”

The High Court in the *Esanda* case (¶4-290) set out the test of when a duty of care is owed to a third party as follows. To be successful, C (the plaintiff, the third party) must allege and prove that: ¹⁹

- A (the defendant, the adviser) knew or ought reasonably to have known that the information or advice given to B (A’s client) would be communicated to C or to the class of which C is a member, and
- the information or advice would be so communicated for a purpose that would be very likely to lead C to enter into a transaction of the kind that C does enter into, and
- it would be very likely that C would enter into such a transaction in reliance on the information or advice from A and thereby risk incurring economic loss if A’s statement should be untrue or the advice should be unsound.

17. (1968) 122 CLR 556 at p 571.

18. *San Sebastian Pty Ltd v Minister Administering the Environmental Planning and Assessment Act 1979* (1986) 162 CLR 341 at p 357.

19. *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) Aust Torts Reports ¶81-420; (1997) 71 ALJR 448, per Brennan CJ at p 63,984; pp 452-453.

The scope of professional negligence is ever widening and has been applied to define duties of care on the part of accountants (¶4-290), architects,²⁰ auditors,²¹ banks (¶16-060 — ¶16-090), builders,²² computer consultants,²³ dentists,²⁴ designers and suppliers of artificial intelligence systems such as electronic weather forecast equipment and credit reports,²⁵ doctors,²⁶ employment referees,²⁷ engineers,²⁸ inspectors,²⁹ insurance agents/brokers,³⁰ insurers,³¹ local councils,³² public authorities,³³ real estate agents,³⁴ solicitors³⁵ (including action by intended beneficiaries under a negligently drafted will: see ¶4-215), tax advisers,³⁶ and valuers.³⁷

20. *Sheldon v McBeath* (1993) Aust Torts Reports ¶81-209.
21. eg *Arthur Young & Co v WA Chip and Pulp Co Pty Ltd* [1989] WAR 100; (1989) 7 ACLC 496 (damages of \$58,000 as a result of a negligent audit); the *AWA case*, set out below.
22. eg *Bryan v Maloney* (1995) 182 CLR 609; ¶4-090.
23. eg Sharpe, A, *Software developers and consultants beware*, Australian Accountant, Vol 60, No 2, p 85 (March 1990).
24. eg *Hribar v Wells* (1995) Aust Torts Reports ¶81-345 (specialist in oral and maxillofacial surgery).
25. US case examples detailed by Sharpe, A, *Computers & Law*, Australian Accountant, Vol 58, No 5, p 129 (June 1988).
26. eg *Locher v Turner* (1995) Aust Torts Reports ¶81-336; Henderson, P, *Medical litigation — the plaintiff's perspective*, LIJ, Vol 70, No 8, p 24 (August 1996); Murray, J, *Medical litigation — the defendant's perspective*, LIJ, Vol 70, No 8, p 28 (August 1996).
27. Thawley, T, *Duty to be careful when giving employees references* (1996) 70 ALJ 403.
28. eg *Pullen v Gutteridge, Haskins & Davey Pty Ltd* [1993] 1 VR 27; (1992) Aust Torts Reports ¶81-170.
29. eg *Northern Territory of Australia v Mengel* (1995) 185 CLR 307 (negligence of stock inspectors not established).
30. eg *Doody v Probert* (1990) 6 ANZ Insurance Cases ¶60-962 (representation that applicant would be insured as soon as premium paid to broker held negligent: cf ¶17-570).
31. eg *Kaze Constructions Pty Ltd v Housing Indemnity Australia Pty Ltd* (1990) ATPR ¶41-017 (misrepresentation by insurer to builder that remedial work ordered by Builders Licensing Board had been carried out: builder's licence cancelled for non-compliance with order).
32. eg *Pyrenees Shire Council v Day* (1998) Aust Torts Reports ¶81-456; (1998) 72 ALJR 152; see below; *Lake Macquarie City Council v Bottomley* [1999] NSWCA 28, noted (1999) 73 ALJ 413.
33. eg *Northern Territory of Australia v Deutscher Klub (Darwin) Inc* (1994) 4 NTLR 25; (1994) Aust Torts Reports ¶81-275 (liability of Fire Service for negligent fire inspection).
34. eg *Rawlinson & Brown Pty Ltd v Witham* (1995) Aust Torts Reports ¶81-341 (no liability); ¶11-160.
35. eg *Hyland v Campbell* (1995) Aust Torts Reports ¶81-352.
36. eg *Hungerfords v Walker* (1989) 171 CLR 125; (1989) Aust Torts Reports ¶80-230, noted (1990) 64 ALJ 364; ¶6-440; *Sweetman v Bradfield Management Services Pty Ltd* (1994) ATPR ¶41-290 (action unsuccessful under *Trade Practices Act 1974* (Cth) sec 52: ¶7-280). Taylor, L, *The adviser's liability — pitfalls and penalties* (1991) 25 TIA 645.
37. eg *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) Aust Torts Reports ¶81-509; (1999) 73 ALJR 901; *Ta Ho Ma Pty Ltd v Allen* [1999] NSWCA 202; (1999) Aust Torts Reports ¶81-512, noted (2000) 74 ALJ 97.

At present barristers are immune from action in negligence in respect of court-room work, and work which would lead to a decision affecting the conduct of a case in court, for at least two public interest reasons: (1) the barrister's paramount duty to the court (such as not to mislead the court, withhold documents, etc) may in fact sometimes disadvantage a client; and (2) the undesirability of re-litigating, between barrister and client, matters which had supposedly been settled in the previous litigation.³⁸ This litigation immunity does not apply to any other work of a barrister.³⁹

— *Case examples* —

Local council. The High Court unanimously found a municipal council negligent for failure to disclose a road widening proposal on a certificate issued to a purchaser under the local government statute as part of a conveyancing transaction. In reliance on the certificate, the purchaser through its solicitor proceeded to complete the purchase, only to find out later that there was in fact a road widening proposal over the property which would considerably reduce its value and prevent proposed development of the site. In awarding the plaintiff damages of \$170,000 for the council's liability for negligent mis-statement, *Gibbs CJ* noted:

"... the person giving the information to another whom he knows will rely upon it in circumstances in which it is reasonable for him to do so, is under a duty to exercise reasonable care that the information given is correct. A public body, by following the practice of supplying information upon which the recipients are likely to rely for serious purposes, lets it be known that it is willing to exercise reasonable skill and diligence in ensuring that the information supplied is accurate. In the circumstances, diligence might be more important than skill, although competence in searching for and transmitting the information must play a part. However, even if diligence only and not skill were required, a public body might be specially competent to supply material which it had in its possession for the purposes of its public functions."

— *L Shaddock & Associates Pty Ltd v Parramatta City Council*⁴⁰ —

The Tricontinental case. Tricontinental, the merchant bank arm of the former State Bank of Victoria, collapsed with losses of over \$2b following reckless lending during the "excesses of the '80s". Australia's largest negligent mis-statement case, lodged by the State of Victoria against KPMG Peat Marwick, the former auditors, was settled in 1994 for \$136m. The auditors claimed

38 *Rondel v Worsley* [1969] 1 AC 191; *Giannarelli v Wraith* (1988) 165 CLR 543; (1987) Aust Torts Reports ¶80-099; *Boland v Yates Property Corporation Pty Ltd* [1999] HCA 64; (2000) Aust Torts Reports ¶81-528; (1999) 74 ALJR 209, noted (2000) 74 ALJ 135; Recent cases, *Barristers — duty to be competent* (2000) 74 ALJ 145.

39. eg *MacRae v Stevens* (1996) Aust Torts Reports ¶81-405, noted (1997) 71 ALJ 116; *Yates Property Corporation v Boland* (1998) Aust Torts Reports ¶81-490.

40. (1981) 150 CLR 225 at p 235; (1981) 55 ALJR 713 at p 717; applied in, eg, *San Sebastian Pty Ltd v Minister Administering The Environmental Planning and Assessment Act 1979* (1986) 162 CLR 340; (1986) Aust Torts Reports ¶80-060. (NSW State Planning Authority held not liable to developer for "study documents" in the absence of specific representation necessary to establish the existence of a duty of care, as the proposals offered no assurance about the ultimate level of development, such proposals frequently being subject to alteration, variation or revocation.)

that the collapse was not their doing and that their duty as auditors did not extend to evaluation of the adequacy, appropriateness or prudence of the board's prudential policies.

*Victoria v KPMG Peat Marwick*⁴¹ —

Local council. An unconfirmed phone conversation with an unknown adviser such as an officer of a municipal council is unlikely to give rise to reliance and a duty of care, but negligence may be proved if the inquirer and adviser are identified to each other, and if there is evidence of reliance from the seriousness of the inquiry, the trust being placed in the adviser, the intention to rely on the information, the fact of reliance and the detriment which followed the reliance. For a duty of care to arise over the phone, the information does not have to be confirmed in writing.

*Woollahra Municipal Council v Sved*⁴² —

After a fire, the shire council (D) was alerted by the fire authority to an unsafe chimney in an old shop in a country town, and its building inspector reported to the council that the fireplaces were *not* to be used under any circumstances unless specified repairs were carried out. The tenant did not notify the owner or the new tenants. There was another fire, and property of the new tenants and the next door neighbours was damaged. The High Court found D in breach of its duty of care to the new tenants and the neighbours, and held D liable in damages for the fire damage. D was aware of the defective chimney, and took no steps under its powers to alert the occupiers or to enforce compliance with the notice. D was aware of the risk of harm and that the damage arising from that risk was foreseeable, and was held liable in negligence for its inadequate response.

*Pyrenees Shire Council v Day*⁴³ —

Planning authorities. The New South Wales State Planning Authority and the Sydney City Council were held not liable to a property developer for their publicly displayed "study documents" on the proposed development of Woolloomooloo in inner Sydney. The developer purchased properties in reliance on the documents, but sold them at a loss when the proposal was abandoned because they were not suitable for development. The High Court held that, as the proposal offered no assurance about the ultimate level of development, there was no specific representation by the planning authorities necessary to establish the existence of a duty of care. Such proposals were frequently subject to alteration, variation or revocation.

*San Sebastian Pty Ltd v Minister Administering
The Environmental Planning and Assessment Act 1979*⁴⁴ —

Auditor. Suing in the company's name, the receiver (¶13-553) of the collapsed Cambridge Credit Corporation Ltd alleged that if the auditors had not

41. 1990-1994, discussed in Sykes, T, *The Bold Riders — Behind Australia's Corporate Collapses*, Allen & Unwin, 2nd ed, 1996, p 460.

42. (1996) 40 NSWLR 101.

43. (1998) 192 CLR 330; (1998) Aust Torts Reports ¶81-456; noted (1998) 72 ALJ 668.

44. (1986) 162 CLR 340.

negligently certified in 1971 that the company's accounts represented a true and fair view of its financial position, the debenture holders of the company would have appointed a receiver in 1971 and the company's financial position would not have worsened over the succeeding three years until the eventual appointment of a receiver in 1974 when the company's debts were \$180m.

At first instance, *Rogers J* of the Supreme Court of New South Wales found that causation had been established in fact and in law, and that the negligent audit was a proximate cause of the company's collapse. Damages were assessed as the difference between the deficiency that would have resulted from receivership in 1971 and the deficiency that resulted from receivership in 1974.⁴⁵ However, the appeal by the auditors — that Cambridge's losses had been caused by government policies, the collapse of a land boom and the company's own business decisions — was upheld by the New South Wales Court of Appeal. The court rejected the argument of Cambridge that if the trustees had known of the breach of the trust deed ratio (by being alerted by the auditors' report), they would have put the company into receivership thus averting further losses. No causal connection (§14-130) could be proved between the auditors' breach in 1971 and the loss of \$145m suffered by the company by reason of its collapse, and there was evidence that Cambridge did not even rely on the audit report or the events constituting the alleged breach of contract. This decision led to settlement between Cambridge's former auditors and its receivers in March 1988, with a payment of \$19.5m to Cambridge, each party paying its own costs.

_____ *Alexander v Cambridge Credit Corporation Ltd (in rec)*⁴⁶ _____

Auditor. AWA (P) suffered losses in foreign exchange operations associated with its electrical business, which were concealed by its foreign exchange manager. These losses were funded by foreign currency loans obtained by the foreign exchange manager. P sued its auditors Deloittes (D) for negligence, alleging that, in the course of two audits of P, D failed to bring to P's notice the full extent of P's foreign exchange manager's operations and that, had it known, P would have taken action earlier to avert further losses. In particular, P claimed that D had a duty to discover, and report to the Board, weaknesses in P's system for foreign exchange dealing, including inadequacies in records, internal control and monitoring of foreign exchange activities.

Rogers CJ (Comm Div) found D negligent for breach of the duty of care owed as auditors but not solely responsible for the losses:

- D should have formed the opinion that proper accounting records had not been kept, and that the absence of internal controls made the weakness in the accounting records worse.
- D should have reported the absence of internal controls to management and, failing action, to management at Board level.

45. *Cambridge Credit Corporation Ltd & Anor v Hutcheson & Ors* (1985) Aust Torts Reports ¶80-706; (1985) 3 ACLC 263.

46. (1987) 9 NSWLR 310; (1987) Aust Torts Reports ¶80-106. This, however, need not

have been the end of the case, as the court had given the receivers of Cambridge leave to argue the validity of the award on other grounds.

However, D's defence was partly successful: *Rogers* CJ found P's management negligent in many respects such as its failure to establish a proper structure of internal controls and its failure to act on D's warning that P's internal controls were inadequate, and he reduced D's liability for contributory negligence (¶14-160) by 20%.⁴⁷

On appeal the Court of Appeal reduced the judgment against D of \$13.6m and interest to \$6m.

Director. The AWA case confirmed that P's directors could be sued by P for negligence for failure to take reasonable care in the performance of their office. Errors of business judgment would be assessed under the test in *Donoghue v Stevenson* (¶14-080): ¶19-480. A company's affairs were confirmed to rest firmly with its management and directors.

*Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson*⁴⁸ —

¶14-270 Vicarious liability of employer. Under the doctrine of vicarious liability, one person may be responsible for the wrongful act of another person due to the legal relationship between them, even if the first person is not personally at fault:

(1) *Employer/employee.* Employers are vicariously liable to third parties for the actions of their employees in the course of their employment. The unlawful action must be within the scope of the employee's actual or implied authority, or incidental to it.

Employers are not vicariously liable for the actions of employees acting outside the scope of employment on a "frolic of their own" — in which case the employee may be personally liable.

An injured person cannot recover from the employer of a person who is an independent contractor rather than an employee, because independent contractors are regarded as principals and liable for their own torts (¶11-020). In New South Wales, South Australia and the Northern Territory an employer is bound, by statute, to indemnify an employee except where the employee's liability was due to "serious and wilful misconduct".¹

An employer held to be vicariously liable for an employee's wrongful act may, in certain circumstances, be able to claim an indemnity from the employee. The employer may have a contractual right to claim an indemnity if the employee's wrongful act amounts to a breach of the employee's contract of service.² In addition, where the employer is guilty of no personal fault,

47. *AWA Ltd v Daniels t/a Deloitte Haskins & Sells (No 2)* (1992) 10 ACLC 933; (1992) 10 ACLC 1,643; noted, eg, *AWA — the anatomy of a \$50m loss*, *The Bulletin*, 19 January, 1993, p 67.

48. (1995) 13 ACLC 614, noted, eg, (1995) 69 ALJ 875; Madgwick, W, *The lessons of AWA*, *Australian Lawyer*, Vol 31, No 10, p 21 (Nov 1996); ¶19-480.

1. *Employees Liability Act 1991* (NSW) sec 5(a); *Wrongs Act 1936* (SA) sec 27C(3); *Law Reform (Miscellaneous Provisions) Act* (NT) (1956) sec 22A(3).

2. *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555; [1957] 1 All ER 125.

the employer may be able to claim an indemnity from the employee as a "joint tortfeasor" under the laws of contribution.³ This principle has been modified by statute in New South Wales, South Australia and the Northern Territory.⁴ In these jurisdictions, an employer is unable to claim an indemnity against an employee unless the employee's wrongful act amounts to serious and wilful misconduct. An insurer has no right of subrogation against an employee of the insured: *Insurance Contracts Act 1984* (Cth) sec 66 (¶17-920).

(2) *Government/employee*. The government (the "Crown") as an employer is open to claims for vicarious liability in the same way as any private employer.⁵

(3) *Principal/agent*. The principal is liable for the actions of the agent acting within the actual or apparent scope of authority, whether or not directed by the principal (¶11-260).

(4) *Partner/partner*. Each partner is vicariously liable for acts or omissions of the other partners if within authority (¶10-270—¶10-280).

¶4-280 Guidelines to assist in avoiding negligent mis-statement. The giving of information and advice is not only the province of professional advisers but is also an essential part of the operation of many government departments and statutory authorities. Often government instrumentalities are the only source of such advice, and the giving of advice may arise from a statutory requirement.

One statutory authority has listed the following precautions to be borne in mind in the giving of advice to the public in particular (but these precautions are equally relevant to the giving of advice to any other person, such as a staff member seeking advice on conditions of employment):

- The employer is under a duty to exercise reasonable skill and diligence to ensure the accuracy of information and advice provided by staff which is likely to be relied upon for a serious purpose by the recipient.
- Staff must remain sensitive to the use an inquirer may make of information or advice sought.
- The standard of care to be exercised by the employee is to be related to the nature of the inquiry and the possible consequences that may arise from the providing of incorrect information or advice.

3. *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) sec 5; *Wrongs Act 1958* (Vic) sec 24; *Law Reform Act 1995* (Qld) Pt 3; *Wrongs Act 1936* (SA) sec 24-27; *Law Reform (Contributory Negligence and Tortfeasors Contribution) Act 1947* (WA) sec 7; *Wrongs Act 1954* (Tas) sec 3; *Law Reform (Miscellaneous Provisions) Act* (NT) Pt IV; *Law Reform (Miscellaneous Provisions) Act 1955* (ACT) Pt IV.

4. *Employees Liability Act 1991* (NSW); *Wrongs Act 1936* (SA) sec 27C(1)(a); *Law Reform (Miscellaneous Provisions) Act* (NT) (1956) sec 22A.

5. *Judiciary Act 1903* (Cth) sec 64; *Crown Proceedings Act 1988* (NSW) sec 5, 6; 1958 (Vic) sec 23, 25; 1980 (Qld) sec 8; 1992 (SA) sec 5; 1993 (Tas) sec 5; 1993 (NT) sec 5; 1992 (ACT) sec 5; *Crown Suits Act 1947* (WA) sec 5.

- If the employee has doubts about the reliability of the information or the employee's authority to provide the advice, these doubts should be made known to the inquirer.
- Although a disclaimer of liability may be possible in some circumstances, a disclaimer would not be appropriate where a department or authority is the only authoritative source of information or advice on the matter and it is reasonable for the information to be provided.
- If information or advice is being given on a matter which has not been finalised, this interim or conditional status should be made clear.
- Where information or advice is requested on a question of legal interpretation, it may be appropriate to advise that such a question is ultimately for the courts to determine, and that an inquirer should not rely on departmental advice, or should seek independent advice from an appropriately qualified person.

¶4-290 Accountants' and auditors' liability to unidentified members of the public.

Company law requires that accounts be kept in compliance with the Corporations Law, and lodged for public access with the Australian Securities and Investments Commission. Two possibilities arise on the question whether company accounts required by statute expose accountants and auditors to liability to "an indeterminate amount for an indeterminate time to an indeterminate class" (¶4-230):

- (1) a person relying on company accounts when investing in a company should have no recourse against the auditor unless the auditor knew that the accounts were going to be made available to the investor; or
- (2) because accounts and audit are a statutory requirement under the Corporations Law, and because they are on ASIC's public register, a duty of care is owed to the public (and, in particular, to the investor or creditor).

The second view is consistent with the Corporations Law and with *Hedley Byrne*, and is supported by commentators:

"What purpose could be usefully served if the public are told: you may inspect the accounts, and other public documents, of X Company Ltd, but don't expect these documents to have been prepared with any degree of skill and care? ... If persons dealing with the company are deemed to have knowledge of the company's public documents then, surely, they are entitled (if not obliged) to rely on this knowledge in dealing with the company."⁶

— Case example —

Fidelity Plc, a company listed on the London Stock Exchange, carried on business as manufacturers and vendors of electrical equipment. On 22 May 1984, the directors of Fidelity (D1 and D2) announced the results for the year ended 31 March 1984 which revealed that profits had fallen below the figure predicted. Reflecting this news, the share price fell from 143p per

6. Baxt, R, *The liability of accountants and auditors for negligent statements in*

company accounts (1973) 36 MLR 42 at p 49.

share on 1 March to 63p by the beginning of June. Fidelity's accounts had been audited by Touche Ross & Co (D3), and were issued to the shareholders on 12 June. Following the announcement of the result, Caparo Industries Plc (P) commenced purchasing shares in Fidelity Plc, starting with 100,000 shares on 8 June, but was not registered as a member until after 12 June, the date the accounts went to shareholders. By 6 July, Caparo's shareholding had reached the British takeover threshold of 29.9% (compare Australia's 20% threshold under the Corporations Law sec 606) and on 4 September it made a bid for the remainder at 120p per share, later increased to 125p on 24 September. By 25 October, Caparo announced that it had acquired 91.8% of the issued shares and it subsequently acquired the balance by compulsory acquisition (under the procedure equivalent to Corporations Law Chapter 6A). Caparo alleged that its purchases of shares were made in reliance on the accounts which were said to be inaccurate and misleading — especially in overvaluing stock and under-providing for after-sales credits such that the apparent after-tax profit of some £1.3m should instead have been shown as a loss of over £400,000. P therefore sued D1 and D2 (the directors) and D3 (Touche Ross) for £10m damages in negligence alleging in the case of D3 that, as auditors, D3 owed a duty of care to investors and to potential investors especially because D3 knew of the company's vulnerability to takeover following the fall in its profits.

In a unanimous decision, the House of Lords held that the auditor owes no duty of care to the public or to an individual shareholder for losses in the value of shares:

- the principal purpose for which annual accounts of a company are prepared and distributed to members is to provide an account of the stewardship of the directors to the shareholders as a body, and not to provide individual investors, whether shareholders or members of the public, with comparative information;
- "The submission that there is a virtually unlimited and unrestricted duty of care in relation to the performance of an auditor's statutory duty to certify a company's accounts, a duty extending to anyone who may use those accounts for any purpose such as investing in the company or lending the company money, seems to me untenable. No doubt it can be said to be foreseeable that those accounts may find their way into the hands of persons who may use them for such purposes or indeed other purposes and lose money as a result. But to impose a liability in those circumstances is to hold, contrary to all the recent authorities, that foreseeability alone is sufficient, and to ignore the statutory duty which enjoins the preparation of and certification of those accounts."

*Caparo Industries Plc v Dickman*⁷ —

This decision leaves the shareholder or bidder who relies on audited accounts no recourse in negligence under the *Hedley Byrne* principle against the auditor or directors for accounts negligently prepared. Because of the public disclosure provisions of the Corporations Law, *Caparo Industries* is

7. [1990] 2 AC 605 at pp 628-629; (1990) 8 ACLC 3,011 at p 3,024, noted, eg, Australian Accountant, Vol 60, No 4,

p 118 (March 1990); (1990) 64 ALJ 436; Charter, Vol 61, No 5, p 16 (June 1990).

not really relevant for Australia, and Australian courts consider such questions as: did the auditors know, or should they have reasonably foreseen, that the accounts might be relied upon? Were they in fact relied upon? What was the period of time between the accounts and the reliance on them?

— *Case examples* —

Auditors not liable. A company's auditors supplied a copy of audited accounts "for review purposes" to a third party (the company's creditor). The court held that this did not give rise to a duty of care to the third party creditor unless the auditor's purpose, or one of its purposes, was to induce the third party or a class which included the third party to act on the statement. Knowledge or belief that the third party would probably rely on the report could not be equated with an intention to induce the third party to rely on the report. In dismissing the claim against the auditors for negligence, the court adopted a test which may make it harder for third parties to sue auditors.

— *R Lowe Lippmann Figdor and Franck v AGC (Advances) Ltd*⁸ —

Auditor liable. The New South Wales Supreme Court held that because the auditors' own manual acknowledged that interested third parties would read and rely on their audit reports, this confirmed the auditors' assumption of responsibility to a class of persons wider than the audited company and its shareholders — such as a potential share purchaser. This case was overruled by the High Court in the *Esanda* case, as the acknowledgement in the manual did not amount to an assumption of responsibility by the auditors.

— *Columbia Coffee & Tea Pty Ltd v Churchill*⁹ —

Auditors not liable. C (the plaintiff) lent money to company B in reliance on B's audited accounts. When B went into receivership, C failed in its negligence claim for pure economic loss against the defendant auditors (A). The High Court held that the mere foreseeability of the possibility:

- that a statement made or advice given by A to B might be communicated to a class of which C is a member, and
- that C might enter into some transaction as a result and suffer financial loss,

is not sufficient to impose on A a duty of care owed to C in the making of the statement or the giving of the advice.

— *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords*¹⁰ —

Merchant bank liable. Reliance by a third party (a bidder) was clearly intended in the *Hill Samuel* case, where directors, merchant bank advisers and accountants were held liable to a bidder for financial statements issued before its bid, a profit forecast issued during the bid and financial matter in the target company's defence documents. Because the defendants were

8. Full Court, Victoria [1992] 2 VR 671; (1992) 10 ACLC 1,168, noted (1993) 11 C & SLJ 127.

9. (1992) 29 NSWLR 141; (1992) 10 ACLC 1,659 (Rofe J, Supreme Court, NSW).

10. (1997) 188 CLR 241; (1997) Aust Torts Reports ¶181-420; noted, eg, Baxt, R, *Third party blues*, Charter, Vol 68, No 5, p 54 (June 1997).

aware that the bidder would rely on them and had intended that reliance, sufficient proximity existed to give rise to a duty of care to the bidder.

_____ *Morgan Crucible Co Plc v Hill Samuel & Co Ltd*¹¹ _____

The purpose of general purpose financial reporting, according to Statement of Accounting Concepts SAC 2 para 7, is to meet the information needs of external parties who cannot obtain the information from the entity. These external parties such as resource providers (employees, lenders, investors), recipients of goods and services (customers) and parties performing review or oversight functions (Parliament, analysts, unions) should be in the mind of the auditor. The aim of the auditor's report is to help "establish the credibility of the financial information".¹²

After a corporate collapse, often the only parties remaining solvent are the legal and accounting advisers. Because of their inability to incorporate with limited liability, they are obvious targets for litigation.

Proposals to limit the liability of auditors include:

- incorporation of auditors, to protect the assets of non-negligent partners;
- contractual limitation — in many situations, a contractual limitation may be ineffective under the *Trade Practices Act 1974* and equivalents. Auditors may face liability under the misleading and deceptive conduct provisions of sec 52 of the *Trade Practices Act 1974* (Cth) (¶7-250ff), the parallel sec 12DA of the *Australian Securities and Investments Commission Act 1989* (Cth) (¶7-240) and sec 995 of the Corporations Law, as well as under non-excludable (¶7-170—¶7-205) warranties of care and skill and fitness for purpose in relation to the supply of services (sec 74: ¶7-095);
- removal of joint and several liability and replacing it with proportional several liability.¹³

Statutory cap for NSW accountants. The *Professional Standards Act 1994* (NSW) provides that members of a trade or association can set up a scheme to reduce the potential financial liabilities of members by enhancing professional standards. The equivalent *Professional Standards Act 1997* has been passed in Western Australia. The Accountants Limitation of Liability Scheme (NSW) is the first scheme under the Act.

11. After takeover, target company found to be worthless. Defendants liable in negligence: (1991) 9 ACLC 3,101; [1991] 2 WLR 655.
12. Statement of Auditing Standards AUS 1, para 8; Statement of Accounting Concepts 2, para 17, 18, 19.
13. Attorney-General's Legal Practice, *Inquiry into the Law of Joint and Several*

Liability (the Davis Report), Report of Stage Two, Canberra, 1995; discussed by Swanton, J and McDonald, B, *Reforms to the law of joint and several liability — introduction of proportionate liability* (1997) 5 TLJ 109; ¶8-840; ¶10-240. Joint Commonwealth and NSW legislation to implement the Report was released in July 1996.

The Accountants Scheme limits (“caps”) the liability of New South Wales accountants to a maximum liability of:

- \$500,000, where the fee charged was less than or equal to \$50,000, and
- ten times the fee (up to a ceiling of \$50m), where the fee was more than \$50,000 (ie from \$50,001).

The liability which is limited by the scheme includes “all civil liability arising (in tort, contract or otherwise) directly or vicariously from anything done or omitted to be done” (clause 3.1).

The Accountants Scheme does not apply to damages arising from death or personal injury to a person, breach of trust, fraud or dishonesty (clause 3.2).

Pre-conditions of the scheme include compliance with the professional accounting bodies’ requirements on:

- adequate professional indemnity insurance;
- continuing education/continuing professional development;
- quality control/quality assurance programs;
- the maintenance and audit of trust accounts; and
- complaints against and the disciplining of members.

The Accountants Scheme was “gazetted” by the New South Wales government under the *Professional Standards Act 1994* (NSW) and came into effect in October 1997.¹⁴

¶4-295 Negligent mis-statement under the *Trade Practices Act*. The *Trade Practices Act 1974* (Cth) has an impact on virtually all Australian business, with some minor exceptions (¶5-010; ¶7-220). Two sections provide alternatives or parallel remedies for negligent mis-statement: sec 52 states that a corporation (to be read widely to include individuals in many circumstances: ¶7-220) shall not engage in conduct that is misleading (¶7-250ff), and sec 74 imposes in contracts for the supply of services to consumers an implied warranty of due care and skill (¶7-095).

14. See further Delaney, G, *Capped — NSW: the premier State*, Charter, Vol 66, No 1, p 14 (February 1995). The Accountants’

Scheme under the *Professional Standards Act 1994* (NSW) is reproduced in CCH *Australian Corporations & Securities Law Reporter* ¶602-032.

CRIMINAL NEGLIGENCE

¶4-300 **Criminal negligence.** Some conduct which may constitute negligence at common law may also involve the criminal law, especially where that conduct has resulted in the death of a person. For example, an engineer was charged with manslaughter by criminal negligence following the collapse of a railway embankment.¹⁵ Consulting engineers were prosecuted for the collapse of the facade of a city building in Sydney.¹⁶ A local government council and its engineer were charged with criminal negligence following the collapse of a wall at a swimming centre.¹⁷

Although obviously the elements of the crime will differ from those of the tort, an area of overlap may be seen where the conduct amounts to recklessness.

15. *Crown v New South Wales Rail Authority* (the *Coledale Railway Embankment case*), discussed, eg, Kinder, D and Ferry, J, *The law tightens on engineers*, Engineers Australia, 12 July 1991. The prosecution failed on the evidence.

16. *Clarke v WL Meinhardt and Partners Pty Ltd* (the *Hunter Street facade case*), New South Wales Industrial Commission, 30 June 1992, unreported, noted, eg, Engineers Australia, 24 July 1992, p 17. Prosecution failed on the facts — could the accused have known of an

unknown and covered-over 150mm hole cut for electrical ducting which had weakened the facade?

17. *Queen v The Mayor Councillors Citizens of the City of Dandenong and Noel Henry Bailey*, County Court, 1 November 1991, unreported, noted, eg, Ferry J, Kinder D and de Jonge, A, Engineers Australia, 29 November 1991, p 36. City engineer acquitted of all charges; council fined \$7,500 for breach of the *Occupational Health and Safety Act 1985* (Vic).

Chapter 5

Formation of Contract

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FORMATION OF A CONTRACT

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¶5-010 Why contract? A contract is a legally binding and legally enforceable agreement. Understanding contracts is fundamental to understanding the whole of business law, because without agreements which are legally binding and enforceable there could almost be no business.

The law of contract provides the answers to questions of enforceability of promises and especially of commercial promises. Many of the business law topics in this book are based on contracts — property, consumer law, trade practices, business organisations; partnership, agency, finance, consumer credit, banking and insurance. Sometimes contract principles have been modified by legislation.

¶5-010

Australian contract law is mainly made up of (1) case law decisions giving effect to community values incorporating current attitudes and (2) legislation such as the original *Statute of Frauds* 1677 (Imp) and modern equivalents on the need for evidence in writing in some situations: ¶5-030).

The most important statute affecting contract is the *Trade Practices Act* 1974 (Cth), in particular sec 52 (¶7-250ff) prohibiting misleading or deceptive conduct. These misleading or deceptive conduct principles affect virtually every contract law topic, from intention to restitution, and no study of contract is complete without examining possible remedies under at least sec 52¹ and sec 53 (false representations: ¶7-290ff).

As an Act passed by the Commonwealth government, the *Trade Practices Act* 1974 (Cth) is limited in its operation to the legislative powers of the Commonwealth as set out in the Constitution (¶1-475, ¶7-220), but for practical purposes most Australian business falls under various Commonwealth powers. Contracts not covered by the *Trade Practices Act* include those not involving a corporation, or not involving interstate trade, or not involving the Commonwealth, or not involving the post and telegraph etc (or not involving the other Commonwealth powers set out in ¶1-475), such as a face to face contract to sell property or buying produce direct from the farm. Instead, these are covered by the equivalent *Fair Trading Act* in each State and Territory.

¶5-015 Contract law and electronic commerce. “Electronic commerce” is a term used to refer to business transactions on, or using facilities provided by, electronic networks including the Internet. Increasingly, business is being done by electronic means rather than by traditional face-to-face business and transactions carried out by the exchange of paper-based documents.

Many areas of Australian business have already adapted to electronic commerce, such as:

- computer crime (¶2-300);
- acceptance of an offer by fax (¶5-320);
- the computerisation of securities and futures markets, with the development of SEATS, SYCOM and CHESS (noted at ¶5-030);
- the confirmation that email falls within the Commonwealth’s power over “postal services” under sec 51(v) of the Constitution (¶1-475; ¶7-220); and
- electronic banking. Financial institutions have been involved in closed-system electronic commerce with their customers for the transfer of funds for many years for wholesale and retail transactions, including ATMs and EFTPOS terminals (¶16-650ff).

1. eg Pengilly, W, *Section 52 of the Trade Practices Act: a plaintiff’s new Exocet?* (1987) 15 ABLR 247.

Australian business law must respond to developments in electronic commerce, for example:

Electronic contracts (cybercontract). The traditional rules of contract law will continue to adapt to assist electronic commerce.

E-commerce legislation. The *Electronic Transactions Act 1999* (Cth), passed on 30 September 1999, provides a legal framework to support and encourage business and consumer confidence in electronic commerce by ensuring that the law treats paper-based commerce and electronic commerce equally so that one is not given an advantage over the other. It is based on the principles of:

- functional equivalence — the law should treat paper-based commerce and electronic commerce the same; and
- technology neutrality — the law should not discriminate between forms of technology.

The Act aims to facilitate electronic transactions, to promote business and community confidence in the use of electronic transactions and to enable business and the community to use electronic communications with the government.

The *Electronic Transactions Act* provides that a transaction is not invalid because it took place electronically (sec 8), and in particular that the following requirements imposed by Commonwealth law can be met in electronic form:

- a requirement to give information in writing (sec 9);
- a requirement to provide a signature (sec 10);
- a requirement to produce a document (sec 11);
- a requirement to record information (sec 12(1)); and
- a requirement to retain a document (sec 12(2)).

This means that electronic signatures can be used in the reported 12,000 instances in legislation where documents must be in “writing” or “signed”.

The *Electronic Transactions Act* is intended to provide the template for uniform State and Territory legislation to operate Australia-wide.

Year 2000 compliance. The *Year 2000 Information Disclosure Act 1999* (Cth),² which commenced in February 1999, was designed to encourage voluntary disclosure and exchange of information about Year 2000 computer problems and remediation effects. For example, it provided protection of a person from civil liability for a “Year 2000 Disclosure Statement” until July 2001.

Consumer protection in electronic commerce. Legal issues to be addressed in e-commerce include providing information to consumers, ensuring the security of payment, the existence of legal remedies and in which jurisdiction, and the maintenance of privacy.

2. Complementary legislation was passed in all jurisdictions, such as the *Year 2000*

Information Disclosure Act 1999 (NSW), (Vic), (SA), (Tas).

On this foundation, the Commonwealth government has put in place the following as the basis for consumer protection in e-commerce:

- self-regulation, with the drafting of a model code of conduct to cover such matters as identification of businesses and security of payments;
- co-operation among enforcement agencies nationally and internationally;
- education, especially by the ACCC and ASIC; and
- the provision of a legal framework to provide certainty in e-commerce.³

NOIE. Details on many of these e-commerce issues are available from the National Office for the Information Economy (NOIE), established in 1997 with legal and physical infrastructure environment for on-line activities, including facilitating electronic commerce”.⁴

¶5-020 Requirements of valid contract. A simple legal definition of a contract runs as follows:

“A contract is a promise or a set of promises which the law will enforce.”⁵

What does it take before the law will enforce a promise or set of promises? Must there be an agreement in writing? Must it be witnessed by a Justice of the Peace or a lawyer? Must it be made with a stern face?

In fact, none of these things is required to form a valid contract. There are six requirements for a legally enforceable contract, equally relevant whether a contract is made between persons or whether it is made instantaneously by electronic messages without written agreements. They are not alternative tests and each of the six must be satisfied for a contract to be valid:

- (1) *Intention to create legal relations.* Do the parties really intend to be legally bound? Or is the arrangement purely “non-business”? (See ¶5-050—¶5-120.)
- (2) *Agreement.* Offer and acceptance, when connected to each other, or equivalent evidence of a concluded agreement (¶5-130—¶5-390), make up an agreement.
- (3) *Consideration.* Unless the agreement is reinforced by “something for something”, it will not be considered a legally enforceable agreement or contract. (See ¶5-400—¶5-500.)

3. Minister for Financial Services and Regulation, *A Policy Framework for Consumer Protection in Electronic Commerce*, Media Release, 28 October 1999.

4. Described as “Australia’s lead Commonwealth agency for information economy issues”: www.noie.gov.au.

5. Guest, AG (ed), *Chitty on Contracts*, Sweet and Maxwell, 27th ed, 1994, p 1. The American Law Institute’s *Restatement of Contracts*, §1 also substantially adopts this definition.

- (4) *Legal capacity*. Is the agreement made while one party lacks capacity, for instance is under age or under the influence of alcohol? (See ¶5-510—¶5-570.)
- (5) *Genuine consent*. Questions arise in this context as to what was actually agreed. What if the goods contracted for have sunk at sea? (See ¶5-610—¶5-810.)
- (6) *Legality of objects*. Can a contract formed for an illegal purpose be upheld? (See ¶5-820—¶5-887.)

Promises which will be enforced by the law of contract must be between different people. A person cannot “self contract”. Equally, a person cannot be both plaintiff and defendant at the same time.⁶

Contract law uses the expression “party” for the people involved in the contract such as the buyer and the seller because they are part of or take part in the contract.

Bearing in mind that “it is one thing for the parties to settle what are to be the terms of an agreement if it should be made; and quite another thing to make the agreement”,⁷ there are two preliminaries to be considered: whether a contract must be in writing (¶5-030) and whether the agreement is a deed (¶5-040).

¶5-030 Must a contract be in writing? Contracts can be classified as:

- (1) those that must be in writing (or else they will be void: see below),
- (2) those that should be evidenced in writing under the *Statute of Frauds* or equivalent (or else they will be unenforceable in court), and
- (3) “the rest” which need no writing. The general rule is that a contract entered into by word of mouth (an oral or “parol” contract) is perfectly valid and creates enforceable rights and obligations between the parties.

Preliminary issues: parol evidence rule. Keeping a written record of what takes place in relation to a contract is sensible business practice. “An oral contract isn’t worth the paper it’s written on”,⁸ and certainly it is preferable to reduce contracts or arrangements to writing where possible, signed by each party to the contract.

If the contract is agreed by the parties to be wholly in writing, the courts are reluctant to allow the parties to go beyond the document itself to present evidence of the meaning of words or to show that a further point was

6. The law does recognise that where a person has different capacities (such as trustee, executor, administrator or agent) that person may have power to contract in his representative capacity with himself: discussed in *Gulland v FC of T* 83 ATC 4352 at pp 4365-4366.

7. *Barrier Wharfs Ltd v W Scott Fell & Co Ltd* (1908) 5 CLR 647 at p 650.

8. Movie producer Samuel Goldwyn, quoted in *Phillippe v Shapell Industries Inc* 743 P 2d 1279 (1987) at p 1291.

omitted. This principle is a rule of evidence, the parol evidence rule. It states that parol or oral evidence is inadmissible to vary, contradict, add to or subtract from the words of a written document. If the parties intend to reduce all terms to writing, the writing must be, and is taken to be, the complete record of the contract (see ¶17-620 regarding insurance policies).⁹

The parol evidence rule is subject to both qualifications and exceptions to ensure its effective operation. Hence, as a qualification to the rule, extrinsic evidence will be admissible:¹⁰

- to prove that the written document is invalid for some reason;
- to show that a party to the contract is an agent of another person;
- to prove that a particular transaction was intended to be partly in writing and partly oral;
- to establish trade usage even though not specifically referred to (but only if not inconsistent with the document);
- to prove the correct nature of the transaction.

There are at least three major exceptions to the parol evidence rule where extrinsic evidence will normally be admissible (comparable in part with those available for the interpretation of statutes: ¶1-550):

- to translate a document, including elucidation of technical terms;
- to explain an ambiguity;
- to demonstrate that a designation is false.

For example, a mistake in a written contract — such as describing the purchaser as the vendor and the vendor as the purchaser — can be cured by evidence of the circumstances of the contract.

Overcoming the parol evidence rule. There are at least two methods of overcoming the strictness of the parol evidence rule:

- If the contract is partly oral and partly written, can it be inferred that the written contract was not intended to contain all the terms of the contract? If so, some of the contract may be contained in oral evidence.
- A collateral contract: in cases where an agreement is not fully in writing it may be possible to establish the existence of a collateral or subordinate contract (see ¶6-030): in consideration of your undertaking that this car was a 2000 model, I agreed to enter this written contract. Or, in consideration of your promise that this boat was capable of this speed,

9. *Mercantile Bank of Sydney v Taylor* (1891) 12 LR (NSW) 252, per *Innes J* at p 262 (affirmed [1893] AC 317): “And it is a rule of evidence, applicable both to Courts of equity and of law, that where a contract is reduced into writing, where the contract appears in the writing to be entire, it is presumed that the writing

contains all the terms of it, and evidence will not be admitted of any previous or contemporaneous oral agreement which would have the effect of adding to or varying it in any way.”

10. eg Heydon, JD, *Cross on Evidence*, Butterworths, 6th Aust ed, 2000, para [39140]ff.

I agreed to enter a written purchase contract. In other words, the consideration given to support the promise (the 2000 model, speed of boat) is the entering of the written contract.

(1) *Contracts that must be in writing: contract void unless in writing.* Some contracts (class (1) above) must be in writing and will be unenforceable if they are not. As the requirement is statutory in most cases, it is unaffected by any repeal of the *Statute of Frauds* (see below). Some other simple contracts, ie contracts other than deeds, will not be enforceable because of the *Statute of Frauds* unless there is written evidence of their terms.

The following contracts are some only of those that *must* be in writing, otherwise they will be void:

- bills of exchange and promissory notes;¹¹
- cheques;¹²
- hire-purchase contracts;¹³
- assignments of copyright;¹⁴
- contracts of marine insurance;¹⁵
- acknowledgements of statute barred debts;¹⁶
- submission to arbitration;¹⁷
- assignments of life insurance policies;¹⁸
- maintenance agreements;¹⁹
- contracts for the employment of seamen;²⁰
- all contracts by deed (see ¶5-040);

11. *Bills of Exchange Act 1909* (Cth).

12. *Cheques Act 1986* (Cth).

13. *Hire-Purchase Act 1959* (Qld); 1959 (WA); 1959 (Tas); ¶14-060.

14. *Copyright Act 1968* (Cth) sec 196(3).

15. *Marine Insurance Act 1909* (Cth) sec 28.

16. *Limitation of Actions Act 1958* (Vic); *Limitation Act 1969* (NSW); *Limitation of Actions Act 1974* (Qld); *Limitation of Actions Act 1936* (SA); *Limitation Act 1935* (WA); *Limitation Act 1974* (Tas);

Limitation Act 1985 (ACT); *Limitation Act 1981* (NT); ¶6-500.

17. eg *International Arbitration Act 1974* (Cth); *Commercial Arbitration Act 1984* (Vic), 1984 (NSW), 1986 (SA), 1985 (WA), 1986 (Tas), 1986 (ACT), 1985 (NT) sec 4; *Insurance Act 1902* (NSW) sec 19; *Commercial Arbitration Act 1990* (Qld) sec 4. See also ¶1-443; ¶17-800.

18. *Life Insurance Act 1995* (Cth) sec 200.

19. *Family Law Act 1975* (Cth) sec 4.

20. *Navigation Act 1912* (Cth) sec 46.

- real estate contracts;²¹
- a transfer of shares in a company;²²
- consumer credit contracts;²³
- mortgages of goods, guarantees and consumer leases regulated by the consumer credit legislation.²⁴

(2) *Contracts that should be in writing: the Statute of Frauds.* The second class of written contracts (class (2) above) are those that will not be enforceable unless there is written evidence of their terms. This is a requirement of proof which dates back to the *Statute of Frauds 1677* (Imp):²⁵

"Section 4

No action shall be brought whereby to charge any executor or administrator upon any special promise to answer damages out of his own estate; or whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriage of another person; or to charge any person upon any agreement made upon consideration of marriage; or upon any contract for sale of lands, tenements or hereditaments, or any interest in or concerning them; or upon any agreement that is not to be performed within the space of one year from the making thereof; unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith or some other person thereunto by him lawfully authorized."

In essence the statute provides no more than that in certain cases the agreement itself must be in writing or there must be some note or memorandum thereof. Failure to reduce the contract to writing does not mean that it is void. It is merely unenforceable in a court. There are a number of classes of contract which have to be evidenced in writing under sec 4 of the *Statute of Frauds* or equivalent legislation:

- A special promise by an executor or administrator to satisfy the liability of a deceased person out of their own money.

21. *Instruments Act 1958* and *Property Law Act 1958* (Vic); *Conveyancing Act 1919* (NSW); *Property Law Act 1974* (Qld); *Law of Property Act 1936* (SA); *Property Law Act 1969* (WA); *Conveyancing and Law of Property Act 1884* (Tas).

22. Corporations Law sec 1091. Uncertificated or paper-free shareholdings were introduced in 1989 with the FAST clearing system (Flexible Accelerated Security Transfer System), to be followed by CHESS (Clearing House Electronic Subregister System).

23. Consumer Credit Code sec 12(a). See further ¶14-180.

24. Consumer Credit Code sec 38(1), 50(1) and 151(1) respectively. See also ¶14-180.

25. The requirement has been repealed or modified in some jurisdictions: eg *Imperial Acts Application Act 1969* (NSW); *Instruments Act 1958* (Vic) sec 126 (introduced by *Sale of Goods (Vienna Convention) Act 1987* (Vic); *Property Law Act 1974* (Qld) sec 59; *Sale of Goods Act 1895* (SA) sec 58 and Schedule; *Law Reform (Statute of Frauds) Act 1962* (WA) (re-enacts sec 4, but deletes executors' contracts (class 1), marriage contracts (class 3) and contracts of over one year (class 4)); *Mercantile Law Act 1935* (Tas) sec 6; *Imperial Acts (Substituted Provisions) Act 1986* (ACT) sec 3(1); sec 4 of the *Statute of Frauds* applies in the NT; see also ¶3-220, ¶9-840.

- A contract of guarantee, ie a special promise to answer for the debt, default or miscarriage of another person (§13-360).
- An agreement made in consideration of marriage.
- An agreement not to be performed within one year from the making thereof. This is important as a matter of business practicality. Contracts required to be in writing under this provision include those which are expressed to extend beyond one year (even if the parties have the power to terminate before one year) and those which cannot possibly be completed within one year. However, a contract which by its terms does not extend beyond one year, even though it may run for over one year (such as a partnership terminable at will), need not be evidenced in writing under the *Statute of Frauds* or equivalent (see §10-020).²⁶
- Generally, a contract for the sale or disposition of land or any interest in land. Section 4 remains in force in Western Australia in this area, and in the Northern Territory, but has been replaced in relation to land law by local legislation in the other jurisdictions.²⁷ This means that all agreements to buy, sell or lease land (subject to certain exceptions relating to short term leases) are caught, as are contracts related to land such as contracts to assign a lease, contracts to grant easements, options to purchase land or to obtain an interest in land such as an agreement to renew a lease.

Statute of Frauds sec 17: *contracts for the sale of goods*. The sale of goods legislation in Western Australia, Tasmania and the Northern Territory is based on sec 17 of the *Statute of Frauds*:²⁸

“A contract for the sale of any goods of the value of Ten pounds or upwards shall not be enforceable by action unless the buyer shall accept part of the goods so sold, and actually receive the same, or give something in earnest to bind the contract, or in part payment, or unless some note or memorandum in writing of the contract be made and signed by the party to be charged or his agent in that behalf.”

The cut-off figure of £10 or \$20 (\$50 in the Northern Territory) was of more significance in 1677; its effect today is that in these jurisdictions

26. eg *Gibb v Sell* [1922] VLR 561.

27. *Instruments Act 1958* (Vic) sec 126; *Conveyancing Act 1919* (NSW) sec 54A; *Property Law Act 1974* (Qld) sec 59; *Law of Property Act 1936* (SA) sec 26; *Law Reform (Statute of Frauds) Act 1962* (WA) sec 2; *Conveyancing and Law of Property Act 1884* (Tas) sec 36; *Imperial Acts (Substituted Provisions) Act 1986* (ACT)

Sch 2, Pt 11. See further Seddon, N, *Contracts for the sale of land: is a note or memorandum sufficient?* (1987) 61 ALJ 406.

28. *Sale of Goods Act 1895* (WA) sec 4 (\$20 and upwards); *Sale of Goods Act 1896* (Tas) sec 9 (\$20 and upwards); *Sale of Goods Act 1972* (NT) sec 9 (\$50 and upwards).

virtually the smallest contract for the sale of goods must be evidenced by writing.²⁹

Evidence by writing. The note or memorandum required by the *Statute of Frauds* and its equivalents need not be a formal legal document. As the section says, a note or memorandum will do, as long as it contains: (1) the name of the parties; (2) the subject matter; (3) the consideration (not applicable in guarantees); and (4) signatures of the parties who wish to enforce the contract.

— *Case example* —

Action by the intending purchaser of a tractor against the vendor for non-delivery failed because the note of the transaction omitted the delivery date and the date for payment, even though these had been agreed to orally by both parties.

————— *JB & BL Nominees Pty Ltd v McCormack*³⁰ ———

The *Statute of Frauds* and equivalents do not prevent legal proceedings from being brought when the contract is wholly in writing. No separate note or memorandum is needed containing the four identifying matters just mentioned to evidence the fact that a contract has been made. The note or memorandum may be contained in several documents, and oral evidence will be admissible to show how the documents are connected.

Effect of non-compliance with Statute of Frauds at common law. If there is no note or memorandum, the contract is not void. Property will still pass under the contract, but if there is any dispute the contract cannot be enforced by legal action at common law because “[n]o action shall be brought”. Money or property transferred cannot be recovered at common law, but there may be a remedy in equity (where there is part performance) or in restitution:

Effect of non-compliance with Statute of Frauds in equity: part performance. In equity, a plaintiff may be entitled to an order of specific performance (¶6-400) in cases where the plaintiff has partly performed its agreement. In other words, equity will not allow a statute to be used as an instrument of fraud. The classic test has been stated as follows:³¹

“1st, the acts of part performance must be such as not only to be referable to a contract such as that alleged, but to be referable to no other title; 2ndly, they must be such as to render it a fraud in the defendant to take advantage of the contract not being in writing; 3rdly, the contract to which they refer must be such as in its own nature is enforceable by the Court; and 4thly,

29. The requirement that a sale of goods contract must be evidenced in writing set out in the Sale of Goods legislation was repealed in NSW by the *Sale of Goods (Amendment) Act 1988*; in Vic by the *Sale of Goods (Vienna Convention) Act 1987*; in Qld by the *Statute of Frauds Act 1972* (Qld); in SA by the *Sale of Goods Act 1895* (SA) sec 58 and Schedule and

in the ACT by the *Sale of Goods Act 1975*.

30. [1982] WAR 258.

31. Northcote, GR, *Fry on Specific Performance of Contracts*, 6th ed, Stevens, 1921, p 276. See also, eg, *Darter Pty Ltd v Malloy* [1993] 2 Qd R 615 at pp 622-623.

there must be a proper parol evidence of the contract, which is let in by the acts of part performance.”

The principle of part performance is available to enable a contract which does not comply with the *Statute of Frauds* requirements of writing to be enforced in equity: “It is enough that the acts [of an applicant relied on as constituting part performance] are unequivocally and in their own nature referable to some contract of the general nature of that alleged”.³²

— *Case examples* —

A cohabitation agreement which was not evidenced in writing, one term of which was that a house was to be left by will, did not qualify under the first test just quoted. In considering the sufficiency of acts of part performance (in this case, the cohabitation for some years), the judge noted:

“... . One must first seek to find such a performance as must imply a contract, and then proceed to ascertain the general nature of such contract as the performance implies, and then to compare *that result*, if one gets to it, with the general nature of the contract pleaded.”

— *Thwaites v Ryan*³³ —

McDonald's. An alleged contract by McDonald's to appoint P a McDonald's hamburger restaurant franchisee was enforceable in equity because P had undergone a year of unpaid training, had qualified for a Bachelor of Hamburgerology and had performed a lot of unremunerated work for McDonald's. However, an alleged contract by McDonald's to appoint P to a specific restaurant was not enforceable in equity as there was no sufficient act of part performance shown by P in reliance on the offer of the restaurant to P.

— *Carr v McDonald's Australia Ltd*³⁴ —

Effect of non-compliance: restitution. Although a contract may not be enforceable if not evidenced in writing as required by the *Statute of Frauds* (or equivalents), a person performing under an unenforceable contract may still be able to recover payment, not on the contract, but in *restitution* so as to prevent the unjust enrichment of the other person (¶6-510). Restitution aims to ensure that as a matter of justice that other person should pay for the benefits received under an unenforceable contract.

32. *Regent v Millett* (1976) 133 CLR 679 at p 683.

33. [1984] VR 65, per Fullagar J at p 77. Compare the more liberal test of the House of Lords for establishing part performance in *Steadman v Steadman* [1976] AC 536: sufficient acts of part

performance were able to be gleaned from the surrounding circumstances as, on the balance of probabilities, they pointed to some contract between the parties showing or consistent with the oral agreement alleged.

34. (1994) 63 FCR 358; ¶9-985.

¶5-040 Deeds. A “free” promise is unenforceable unless it is contained in a deed. A deed is a written or printed document which creates an obligation between parties — such as the creation of a trust by a trust deed (¶9-755). A deed gets its effectiveness from its form or from the formula that it is “signed, sealed and delivered”. A contract contained in a deed is therefore called a “formal contract” because it gets its effectiveness from its form.

A unilateral deed (executed by one party only) is called a deed poll.

If the formalities are not complied with, the instrument will not be an effective deed. The differences between contracts by deed (or formal contracts) and simple contracts are:

- (1) The validity of a contract by deed depends on its formal requirements, whereas simple contracts have no formal requirements.
- (2) A contract by deed requires no consideration. Simple contracts, by contrast, must be supported by consideration to be enforceable (¶5-400ff).
- (3) Parties to contracts by deed can bring action at common law for non-performance and performance different from that contemplated by the deed. However, they cannot obtain the equitable remedy of specific performance unless consideration has been given, for, as one of the ancient maxims of equity puts it, “equity will not assist a volunteer”.

Signed. The person making the deed must sign it,³⁵ and the signature on the deed must be witnessed (or attested) by at least one witness who is not a party to the deed.

A deed that contains promises by one party will only need to be executed, ie signed, sealed and delivered by the party making the promises; however, if it contains covenants by several parties, as in a lease (where the landlord promises to repair and the tenant to pay rent), each party must “sign, seal and deliver” in order to be bound by the deed.

Sealing. An instrument is sufficiently sealed if the party with intent to seal affixes in wax an impression of that party’s coat of arms (or finger, die or stick) on a “wafer” or merely on the paper or parchment. It is not necessary that any mark or impression should be left, provided there is an intention to seal.³⁶ The modern practice is to affix foil stickers which are obtainable from legal stationers.

Delivery. A deed does not take effect until delivery. Delivery, however, need not involve any actual handing over so long as the maker of the deed shows an intention to be bound by the deed. A deed can therefore be “delivered” without leaving the possession of the executing party. The concept of delivery of a deed is indeed an archaism or a legal fiction.³⁷

35. eg *Conveyancing Act 1919* (NSW) sec 38(1); *Property Law Act 1958* (Vic) sec 73; 1974 (Qld) sec 45; 1969 (WA) sec 9.

36. *Re Sandilands* (1871) LR 6 CP 411.

37. eg Butt, P, *Deeds — the problem of delivery* (1978) 52 ALJ 454; *Working Paper on deeds and escrows of the Law Commission of England and Wales* (1986) 60 ALJ 355.

Further:

- (1) The doctrine of estoppel prevents disputing of one's own deed and denial of the truth of its contents. But a deed will not operate as an estoppel where one party wishes to allege fraud, duress, mistake, unconscionability, illegality or lack of capacity.
- (2) The limitation periods on deeds are far longer than the six years for actions on contracts; examples of extended limitation periods are: 12 years (New South Wales, Queensland, Tasmania, Australian Capital Territory, Northern Territory); 15 years (Victoria and South Australia); 20 years (Western Australia). The period does not start to run until the date when the cause of action arises. It may be decades before action on a deed becomes statute barred.

Common law or statute law requires that several types of contract must be in the form of a deed to be valid. These include:

- A gratuitous promise — ie a promise made without consideration. The formality required in signing, sealing and delivering is considered to be sufficient to indicate that the parties intended to be legally bound (eg some trusts, see ¶9-755; ¶9-760).
- The appointment of an agent to have power to contract by deed. Where a deed is required for an agent to be able to enter a deed, the agent will have to be appointed by a deed, known as a power of attorney (see ¶11-030).

INTENTION TO CREATE LEGAL RELATIONS _____

Importance of intention	¶5-050
Commercial agreements	¶5-060
Commercial agreements: contracts with government	¶5-070
Commercial agreements: advertisements	¶5-080
Family, domestic, social and voluntary agreements	¶5-090
Other domestic agreements	¶5-110
Social and voluntary agreements	¶5-120

¶5-050 Importance of intention. The mere fact of an agreement (as shown by mutual promises) does not in itself create a contract. The law requires evidence of some intention of the parties (express or implied) to become bound in a legally enforceable contract, and as a result two presumptions have developed to assist in determining whether or not the parties intended to create legal relations:

- (1) It is presumed that parties to an agreement concerning commerce or business intend to be legally bound (¶5-060—¶5-080).
- (2) It is presumed that parties to an agreement of a family, domestic, social or voluntary nature do not intend to be legally bound (¶5-090—¶5-120).

¶5-050

The test applied by the courts is objective, not subjective; it is not what the parties had in mind which is decisive but what inferences could be drawn from the words or conduct of the parties. Not carrying out the intention as understood by the other party may be actionable under sec 51A, 52, or 53 of the *Trade Practices Act 1974* (Cth) (see ¶5-010).

¶5-060 Commercial agreements. The presumption that a commercial agreement is intended to create legal relations can be rebutted. For example, the parties may agree that their agreement is binding “in honour only” and that it is not a contract.

— *Case example* —

A contract for the supply of tissue paper stated: “This arrangement is not entered into ... as a formal or legal agreement ... but it is only a definite record of the purpose and intention of the ... parties ... to which they each honourably pledge themselves ... that it will be carried through ... with mutual loyalty and friendly co-operation.” The agreement was terminated without the required notice being given and the plaintiff tissue paper manufacturer sued for damages for breach of contract. The action failed. The court found that there was no contract and only an agreement binding in honour: “The intention clearly expressed is that the arrangement set out in the document is only an honourable pledge, and that all legal consequences and remedies are excluded from it.”

— *Rose & Frank Company v JR Crompton & Bros Ltd*³⁸ —

An agreement, even if it is of a commercial nature which could normally form the subject of a contract, can be expressly taken outside the law of contract by the words, actions or intentions of the parties.

— *Examples* —

Competitions and lotteries. (1) Some competitions state that entering the competition does not create a legal relationship between the entrant and the competition organisers, such as the statement appearing on an entry ticket which read “entry to this competition does not constitute a legal relationship between the entrant and the competition organisers”.³⁹

(2) Most competitions do give rise to legal obligations. For example, buying a lottery ticket was held to involve entering a contractual relationship under which, in consideration of entrants’ buying tickets, the lottery would administer the proceeds so that there would be funds to buy and award the prizes.⁴⁰

(3) Entering the “Monopoly McMatch and Win Competition” in 1999 did create a valid contract between the entrant and McDonald’s under which McDonald’s would be contractually bound to award a prize to the winner, but the contract contained two conditions: (a) claims for prizes were ineligible if they failed McDonald’s security and verification checks, and (b) McDonald’s

38. [1923] 2 KB 261; [1925] AC 445.

39. *Jones v Vernon’s Pools Ltd* [1938] 2 All ER 626 (similar clause held to prevent creation of legal relationship).

40. *Potts v Smith* [1993] 2 Qd R 44. The prizewinner was awarded damages when the lottery was unable to award her the first prize.

decision on all matters arising would be final. McDonald's was entitled to reject ineligible claims for prizes.⁴¹

However, not every commercial agreement leads to a binding contract, as shown in the following two cases:

— *Case examples* —

The "comfort letter". Subsidiary Ltd, a wholly owned subsidiary of Defendant Ltd (D) (formed to operate as a ring-dealing member of the London Metal Exchange), applied to merchant banker Plaintiff Ltd (P) for a £5m loan facility (later increased to £10m) through an acceptance credit/multi-currency cash loan facility. As security for repayment, merchant banker P wanted some kind of guarantee of repayment by Subsidiary Ltd's holding company D but was informed by D that it was not its policy to guarantee the borrowing of its subsidiaries. However, after much negotiation between P Ltd, Subsidiary Ltd and D, D forwarded to P a "comfort letter" which read in part: "It is our policy to ensure that the business of [Subsidiary Ltd] is at all times in a position to meet its liabilities to you under the above arrangements." With a decline in the market following the collapse of the International Tin Council, Subsidiary Ltd ceased trading and sustained heavy losses, owing P some £12m plus interest. Instead of turning to Subsidiary Ltd, P claimed immediate repayment from D. D denied any liability, arguing that no contract existed between D and P.

The English Court of Appeal held that this statement was not contractual on the basis that it was only a statement of D's policy, and not a promise that this policy would be continued in future. In its letter, D did not promise to accept liability for Subsidiary's losses. The statement was therefore in marked contrast to the promise analysed as contractual in the preceding paragraph of the letter which read "We confirm that we will not reduce our current financial interest in [Subsidiary] ..."

— *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad*⁴² —

Ken Morgan Toyota. Ken Morgan Toyota was in financial difficulties by 1990, and commenced negotiations for financial assistance in a rescue package with Toyota. Toyota faxed a letter to Ken Morgan which referred to its "Proposed Offer" and the "Conditions of the Proposed Offer", which Ken Morgan purported to accept. The rescue package later fell through, and Ken Morgan unsuccessfully sued Toyota for alleged breach of contract. There was no evidence of a contract. In particular, the statement "If business condition ie financial position is acceptable ... we will proceed" was held to be a statement of present intention and not a contractual promise. Negotiations, no matter how heavily commercial in character, are no substitute for promissory intention, and there is no presumption that the legal effect of a transaction is necessarily contractual.

— *Toyota Motor Corporation Australia Ltd v Ken Morgan Motors Pty Ltd*⁴³ —

41. *Hurley v McDonald's Australia Ltd* 43. [1994] 2 VR 106. (2000) ATPR ¶41-741; ¶7-280.

42. [1989] 1 WLR 379; noted eg (1989) 63 ALJ 370.

These cases and others on “comfort letters” have distinguished statements of intention (not contractual) from promises, undertakings and obligations (contractual). However, sometimes the law will try to bring “legal obligation into closer alignment with the call of commercial morality”⁴⁴ by enforcing commercial agreements through areas of law other than the law of contract, such as by:

- (1) the prohibition of misleading or deceptive conduct under sec 52 of the *Trade Practices Act 1974* (Cth) and State/Territory *Fair Trading Act* equivalents: ¶7-250—¶7-281;
- (2) the law of promissory estoppel, which prevents a party going back on its word: ¶5-485;
- (3) the prohibition of unconscionable conduct: ¶5-730—¶5-760.

¶5-070 Commercial agreements: contracts with government. Government activity at federal, State/Territory and the local level plays an important role in Australian business, but does it express an intention to create legal relations enforceable in law? As administrative agencies (eg providing assistance or a social service), there is no presumption that government activities give rise to contractual intention.

— *Case example* —

When P’s cattle became infested by cattle tick, P approached the Department of Agriculture for assistance under its tick eradication scheme. An arrangement was made under which two officers of the department would spray the cattle and P would be responsible for mustering, etc. The department officers failed to carry out the job efficiently, P’s cattle became even more tick-infested and P sued for breach of contract. P was unsuccessful in contract as the spraying was held to constitute a general policy of pest control based on an administrative arrangement which did not have as its basis legal relationships of a contractual nature.

— *The Administration of the Territory of Papua and New Guinea v Leahy*⁴⁵ —

As shown in this case, a transaction with a public authority carrying out a statutory function is not normally contractual, even if a fee is paid. In contrast, government commercial activities such as contracting for the purchase and supply of goods and services give rise to a presumption of contract.⁴⁶

¶5-080 Commercial agreements: advertisements. Until the advent of the *Trade Practices Act* in 1974, extravagant claims about the

44. *Banque Brussels Lambert SA v Australian National Industries Ltd* (1989) 21 NSWLR 502, per Rogers CJ at p 505. See also Scott, S, *Comfort letters — let the issuer be aware!* (1994) 5 JBFLP 197.

45. (1960-1961) 105 CLR 6.

46. The *Trade Practices Act 1974* (Cth) expressly applies to the Commonwealth government in so far as it carries on a business (¶8-020); eg Seddon, N, *Government Contracts—Federal, State and Local*, Sydney, Federation Press, 1995.

benefits of advertised goods, perhaps supported by vague promises or guarantees if the goods did not live up to expectations, were fairly common. Plaintiffs attempted to enforce promises made in advertisements by showing they were induced to buy on the faith of them. In reply the advertiser argued that there was no intention to create legal relations and that therefore there could not be any contract upon which to sue.

— *Case example* —

An advertisement was inserted in various newspapers by the proprietors of a medical preparation called “The Carbolio Smoke Ball”. In their advertisements, the proprietors offered to pay £100 to any person who contracted influenza after using the ball three times a day for two weeks. They added that they had deposited £1,000 at the Alliance Bank, Regent Street “to show our sincerity in the matter”. The plaintiff bought the medicine, used it as directed and still caught influenza which plagued her over the English winter months of 1891-1892. She sued for the £100 and one of the defences raised was that the matter was no more than an advertising “puff” and that there was therefore no intention to create legal relations. This argument was rejected on the basis that the £1,000 deposited at the bank was clear evidence of an intention to pay claims.

— *Carlill v Carbolic Smoke Ball Co*⁴⁷ —

Numerous issues, including the following, were raised:

- (1) Was there an intention to create legal relations (§5-050)?
- (2) Was the advertisement a mere “puff”?
- (3) Can an offer be made to the whole world (§5-212)?
- (4) Need acceptance or an intention to accept an offer be communicated (§5-310)?
- (5) Can performance of a condition of an offer constitute sufficient acceptance of that offer (§5-310)?
- (6) Was the contract made when the offeree did the act requested (§5-310)?
- (7) Did the offeror make notification of performance by the offeree a condition of the offer (§5-310)?
- (8) Was the advertisement too vague to form the basis of a contract (§5-140; §6-150—§6-170)?
- (9) What was the consideration (§5-400) offered by the user? Buying the product, or using it? If it was the latter, could that form consideration for the seller’s promise to pay?
- (10) Was this a wagering contract which was void under statute for illegality (§5-825—§5-827)?

47. [1892] 2 QB 484; affirmed [1893] 1 QB 256; [1891-94] All ER Rep 127.

The decision (discussed further in ¶5-212) does not mean that all promises contained in advertisements can lead to enforceable contracts; the bank deposit was a factor making this advertisement contractual. If all advertisements were to be treated as contractual offers instead of advertising “puffs”, the courts would be forever passing judgment on the contractual merits or otherwise of various advertised products. However, advertisements, even if mere “puffs”, now have to comply with the requirements of statute law, in particular sec 52 of the *Trade Practices Act 1974* (Cth) (see ¶7-250ff). This section makes any “misleading or deceptive” conduct, statement or action an offence which can be sued upon by the injured party, or even by a party such as a trade competitor not injured directly (subject to limits set out in ¶5-010).

¶5-090 Family, domestic, social and voluntary agreements.

There is a legal presumption that parties to an agreement concerning a family, domestic, social or voluntary matter will not intend to be legally bound. The agreement may be morally binding, but non-commercial disputes rarely come before the courts except in the Family Court jurisdiction. It is a question of construction or interpretation of the words used and the surrounding circumstances as to whether legal relations were intended. The test is objective, based on how the reasonable person would interpret the agreement.

If a husband and wife settle on a figure for housekeeping to be paid to one of them, non-payment of this figure would not be expected to lead to an action in the civil courts. But the relationship of husband and wife does not of itself rule out the formation of a contract.

— Case examples —

No intention to create legal relations

Mrs Balfour (P) stayed in England on medical advice after her husband (D) returned to work in Sri Lanka. At the time, the couple were living “in amity”. In consideration of P agreeing to support herself, D promised to pay her £30 per month as maintenance until they were reunited. Later D suggested they remain apart, and when the payments fell into arrears, P unsuccessfully sued for breach of contract. The court held that the arrangement was an ordinary domestic arrangement and that no legally binding contract was intended.

— *Balfour v Balfour*⁴⁸ —

Miss X and Mr Y were engaged to be married. Among other arrangements Miss X suggested that after the marriage she should be paid a dress allowance of £100 a year to be paid in quarterly instalments of £25. This was agreed to by Mr Y, and after the marriage he paid the allowance for a while. The parties later separated and Mrs Y (as she now was) claimed, amongst other matters, that this arrangement created a binding contract. The claim was rejected on the basis that legal relations on this point were not intended: “[t]he parties did no more, in my view, than discuss and

48. [1919] 2 KB 571.

concur in a proposal for the regular allowance to the wife of a sum which they considered appropriate to the circumstances at the time of marriage.”

*Cohen v Cohen*⁴⁹

Consider what it would take for the arrangement in the *Cohen case* to be legally effective; it did not fail merely because it concerned spouses. For example, if Mrs Y was employed as an assistant at Y's business and the £100 pa was to be used exclusively for the purchase of suitable clothes to give a successful aura to the business, it could be argued that the agreement would be effective because it would take on an essentially commercial nature. But if Y was departing for overseas on business for 12 months and had instructed his bank to pay Mrs Y a monthly allowance which included so much for house payments, so much for food and the £100 for clothing, a borderline situation would be reached. Although the payments would clearly involve the bank in an enforceable commercial contract, it would still be arguable that Mrs Y's rights with Mr Y were governed by the agreement between them of a domestic and therefore non-commercial and non-enforceable nature. In other words, the contracts with the bank would be enforceable as a normal commercial contract, but the arrangement between the spouses would not be so enforceable.

Case example

Intention to create legal relations

After a husband and wife had separated, they had a meeting in the husband's car in which the husband agreed to pay the wife £40 per month maintenance. He also wrote out and signed a document in which he stated that in consideration of the wife's paying all the charges in connection with the matrimonial home until the mortgage payments had been completed, he would agree to transfer the property to her sole ownership. The husband later failed to transfer the property to his wife. She claimed a declaration that she was the sole beneficial owner and asked for an order that her husband should transfer the property to her under their agreement. By way of defence the husband argued that the agreement was of a family nature and that it was not intended to create legal relations. The defence failed and the court held the agreement to be enforceable because (1) it was made when the parties were not living together under ordinary circumstances and (2) the argument that there was no consideration to support the husband's promise was rejected in that the wife, in performing the act of paying the mortgage payments, had given ample consideration.

*Merritt v Merritt*⁵⁰

49. (1929) 42 CLR 91, per Dixon J at p 96. 50. [1970] 2 All ER 760.

Where an agreement between a husband and wife is intended to create legally binding relations this intention should be made clear. It should be supported by a note or memorandum, ideally prepared by a legal adviser.⁵¹

¶5-110 Other domestic agreements. The presumption that domestic arrangements do not give rise to legal consequences may affect parties to domestic arrangements other than those between husband and wife. The tests on intention to create legal relations may also be applied in such contexts.

— *Case example* —

Intention to create legal relations

P and her husband were persuaded by P's brother D, an elderly and wealthy widower living alone near Sydney, to sell up in England, move to Australia and share his house and care for him during his declining years. P's husband had to make a big sacrifice to make the move, including resigning from his position at Cambridge University and giving up his salary and pension. D promised to pay their passage and a regular allowance, and he promised that he would leave his house to them in his will. After about a year, the agreement broke down, and D moved out and sold the house. When D altered his will, P sued D for breach of contract and won. The presumption that there was no intention to create legal relations was rebutted as there was evidence of a binding and enforceable contract because of the economic seriousness of the situation to P. The contract was not void for uncertainty (¶6-150), and it contained an implied term (¶6-110) that D would not alter his will later without P's consent.

*Wakeling v Ripley*⁵² —

¶5-120 Social and voluntary agreements. The presumption against finding a legally enforceable arrangement may arise in other non-commercial circumstances.

Social agreements. Many of the obligations of clubs and societies would not be considered to be legally enforceable. A club member winning a bowling competition would not be in a position to sue for the prize if the prize was awarded to another person or a dispute arose about who was actually entitled to the trophy.

Voluntary agreements. Similarly, the law presumes that a voluntary agreement is not intended to create legal relations:

— *Case examples* —

D entered a trial arrangement with P, a disabled and unemployed man, to see if P was able to paint the outside of D's house. During the test, which

51. "If it [the agreement] were included in a written document, I have no doubt the court would enforce it. I should also do so when it is included in an oral agreement." *Gould v Gould* [1969]

3 All ER 728, per Lord Denning MR at p 731.

52. (1951) 51 SR (NSW) 183. For similar facts, see *Todd v Nicol* [1957] SASR 72 and *Riches v Hogben*, ¶5-485.

was to last for only a few hours, P fell off the ladder and was injured. If there was a contract of employment, P would be able to claim workers' compensation (¶17-065). The High Court held that no intention to create legal relations could be inferred. D's nominal payment to P was a gratuity and P was under no legal obligation to D. The mutuality of obligation which is essential to the formation of a contract was not present.

*Dietrich v Dare*⁵³ —

"*Teen Ranch*". P, who was injured while working at a camp run by a non-profit Christian organisation, was unable to claim workers' compensation (¶17-065) as there was no evidence of a contract of employment. The court found no intention by the parties to create legal relations: P's work was voluntary, even though P was expected to observe camp discipline while on duty.

*Teen Ranch Pty Ltd v Brown*⁵⁴ —

AGREEMENT

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53. (1980) 54 ALJR 388.

54. (1995) 38 AILR ¶5-036.

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¶5-130 What makes a legally enforceable agreement? An agreement may fall short of being a legally enforceable contract:

- (1) The rules of offer and acceptance help determine whether a contract exists — whether an *offer* was made by one party (the offeror) which was *accepted* by the other party (the offeree): ¶5-140ff.
- (2) The courts may also take a “global approach”⁵⁵ to work out whether the parties have reached a concluded contract: “a contract may be inferred from the acts and conduct of parties as well as or in the absence of their words”.⁵⁶

The conduct of the parties — what they said, meant and did — is examined so that one can determine whether a “meeting of the minds” really took place.

An agreement has been defined thus:

“... an agreement is the union into a single, whole, and undivided declaration of will of declarations, each in the same sense, by several persons of their wills in respect of a particular matter ... Clearly there can be no such single declaration of will unless each party knows what the others have declared to be their several wills. Each must therefore communicate his intention in the matter to the others ... The declaration of will of one party must take the form of a proposal to the others, and the concurring declarations of will of the others must be in terms assents to that proposal. In the law of contract such a proposal is commonly called an offer and the assent to it an acceptance of it.”⁵⁷

Sometimes the facts of an agreement cannot be analysed as an offer and an acceptance, yet a contract may still be inferred from the acts and conduct or the circumstances of the parties. In the words of one judge:⁵⁸ “Even though it may not be possible to identify an offer and an acceptance, the conduct of

55. eg *Marist Brothers Community Inc v Shire of Harvey* (1995) 14 WAR 69 at p 74.

56. *Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd* (1988) 5 BPR 11,110, per *McHugh* JA (as he then was) at p 11,117.

57. Salmond J and Williams J, *Principles of the Law of Contracts*, London, Sweet and Maxwell, 2nd ed, 1945, pp 69-70. So long as there is a “manifestation of mutual assent”, a contract may exist even though no offer and acceptance can be identified. Analysis of the formation of a contract by reference to the rules of offer and acceptance is sometimes criticised as being not a satisfactory or at least not a comprehensive means of determining the existence of a concluded contract: eg *Vroon BV v Foster’s Brewing Group Ltd* [1994] 2 VR 32.

58. *Heather v Vita Pacific Ltd* (1996) 6 Tas R 52, per *Zeeman* J at p 57.

the parties may be such as to make it possible to discern a sufficient consensus to justify the conclusion that a concluded contract has come into existence”.

— *Case example* —

In a letter to the secretary of the organising club, each participant in a yacht race signed undertakings to be bound by the club sailing rules while competing. This signing was held to indicate a contract between all competitors, evidenced by the race rules, with a contractual liability on the part of one to the other.

————— *Clark v Earl of Dunraven and Mount-Earl*⁵⁹ ———

However, the mere participation in a race will not of itself provide the basis of a contract between the participants and the organising club without evidence of intention to contract from the acts and conduct of the parties.⁶⁰

Agreements, whether made orally, in writing or by electronic data interchange (¶16-650), involve the same issues regarding the time of the formation of the contract and its terms.

Non-contractual agreements may still be enforceable if they are legally actionable as “misleading or deceptive conduct” under sec 51A or 52 of the *Trade Practices Act 1974* (Cth) (¶7-250ff) or as false representations under sec 53 (¶7-290ff) (in areas where the Act operates: ¶5-010). The rapidly growing body of case law under these sections shows the potential for strong legal enforcement of agreements which may technically fail to constitute a legally enforceable contract.

Sometimes even if both parties have not agreed, the law will impose an “agreement” where one person has profited at the expense of another. Recovery may be allowed in restitution (¶6-510). A constructive trust may be imposed (¶9-755).

¶5-140 Offer. An offer is a definite undertaking — ie one which is not too vague — made with the intention (which may be objectively ascertained) that it shall become binding on the person making it as soon as it is accepted by the person to whom it is addressed.⁶¹ In other words, it is a proposition which will become a contract upon its acceptance. There are several legal rules which assist in determining the exact status of communications passing between the parties:

- (1) An offer must be distinguished from an invitation to treat (¶5-150—¶5-210) and an option (¶5-365).
- (2) An offer can be made to a specific person or persons, or to a class of persons, or to the whole world (¶5-212).
- (3) An offer must be communicated (¶5-215).
- (4) An offer can be revoked at any time before acceptance (¶5-360).

59. [1897] AC 59.

61. *Hart v Mills* (1846) 15 LJ Ex 200.

60. *Forbes v Australian Yachting Federation Inc* (1996) 131 FLR 241.

¶5-150 An offer must be distinguished from an invitation to treat. At issue here is the status of those preliminary communications which pass between parties at the negotiation stage before a definite offer is made. The legal expression for these early communications is “invitation to treat”: they are “cases in which you offer to negotiate, or you issue advertisements that you have got a stock of books to sell, or houses to let, in which case there is no offer to be bound by any contract. Such advertisements are offers to negotiate — offers to receive offers — offers to chaffer ...”.¹ The following paragraphs (¶5-160—¶5-210) provide examples of invitations to treat.

¶5-160 Invitation to treat: price lists, circulars, catalogues, advertisements. Placing a classified advertisement in the newspaper would not bind a seller to accept at the first reply. If you had to sell to everyone complying with the terms of the advertisement (that is, accepting your offer), you would face contractual liability with all takers.²

— *Case example* —

Partridge advertised certain birds in a periodical called *Cage and Aviary Birds* as “Quality British ABCR ... Bramblefinch cocks, Bramblefinch hens, 25/- each”. The advertisement appeared under the heading “Classified Advertisements”, but in no place did the words “offer for sale” appear. When Partridge was indicted with unlawfully offering live wild birds for sale, the question arose whether the advertisement constituted an offer for sale or only an invitation to treat. The second view was upheld.

— *Partridge v Crittenden*³ —

The legal effect of price lists has been analysed as follows:

“... The transmission of such a price-list does not amount to an offer to supply an unlimited quantity of the wine described at the price named, so that as soon as an order is given there is a binding contract to supply that quantity. If it were so, the merchant might find himself involved in any number of contractual obligations to supply wine of a particular description which he would be quite unable to carry out, his stock of wine of that description being necessarily limited.”⁴

¶5-170 Invitation to treat: goods on display in shop. It is generally accepted that goods on display in a shop constitute an invitation to treat rather than an offer. In the former case, the shop need not accept the customer’s offer to buy and has the right to refuse to sell to the customer. In the latter case, the shop would have to accept the customer’s acceptance

1. *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256, per Bowen LJ at p 268.
2. This was the case in *Carlill*, *supra* (see ¶5-080, ¶5-212). Generally, advertisements are only invitations to treat.
3. [1968] 1 WLR 1204; [1968] 2 All ER 421.
4. *Grainger v Gough* [1896] AC 325, at p 334; (but see *Trade Practices Act 1974* (Cth) sec 56(2): ¶7-420).

of the shop's offer to sell. In one case, counsel suggested that "if a man advertises goods at a certain price, I have a right to go into his shop and demand the article at the price marked", to which the judge replied: "No; if you do, he has a right to turn you out."⁵ In other words, it is the would-be buyer who makes the offer when tendering the price and the shop-keeper, if the item were wrongly priced, would be entitled to say, "I am sorry; the price is \$50 not \$40" and refuse to sell.⁶

¶5-180 Invitation to treat: goods on display in self-service shop or supermarket. Goods on display in a self-service shop generally do not constitute an offer to sell. This point was clearly decided in 1952.

— *Case example* —

A chemist's shop was organised along self-service lines where goods, including "prescribed" drugs, were displayed on open shelves. Customers selected their required articles and took them to the check-out. At the exit there was a registered pharmacist who supervised each transaction and who was entitled to refuse the sale of goods to any customer. The Pharmaceutical Society of Great Britain alleged that sales were in contravention of legislation⁷ which prevented the "sale" of prescribed drugs unless made under the supervision of a registered pharmacist. The issue was: when did the "sale" take place — when the items were taken from the shelf (acceptance by the customer of an offer and unsupervised) or when they were checked out (acceptance by the shop of an offer and supervised)? The prosecution failed as it was held that the exposure of the goods on the shelf indicated a willingness to "treat" but that an offer was not made until made by the customer at the check-out: in other words, the "sale" of the prescribed drugs was made under the supervision of a registered pharmacist as required by law.

— *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd*⁸ —

Questions of common sense and of commerce were applied in this case. If the picking up of the item from the shelf constituted a sale, it would mean that ownership of the item would immediately pass to the customer. The customer would not be able to have a change of mind and return the item to the shelf; the supermarket would not be able to prevent the customer from taking the item (it might be the last in stock which the supermarket wanted to keep on display on the shelf). Accordingly, self-serve shops were placed in the same legal position as other shops regarding goods placed on display.

5. *Timothy v Simpson* (1834) 6 C & P 499 at p 500; 172 ER 1337 at p 1337; see also *Fisher v Bell* [1961] 1 QB 394; [1960] 3 All ER 731.

6. But perhaps face liability under sec 52 or 53(e) of the *Trade Practices Act 1974* (Cth) for "misleading and deceptive conduct": see ¶7-250ff; ¶7-350.

7. eg *Pharmacy and Poisons Act 1933* (UK) sec 18 (now repealed); cf eg *Pharmacy Act 1964* (NSW) sec 27-28; 1908 (Tas) sec 31; *Pharmacists Act 1974* (Vic) sec 28; 1991 (SA) sec 33.

8. [1953] 1 QB 401.

¶5-190 Automatic vending machines — not an invitation to treat.

Is a chocolate machine, or an automatic ticket machine in a parking station, an invitation to treat or does it represent an offer to the world which is accepted when a coin is put in the machine? If the latter, inserting a coin into the machine would constitute acceptance of the offer, and if the machine did not deliver (being either empty or out of order) the machine proprietor would be liable for breach of contract. If the former, the law could define inserting the coin as the offer, and if it was not accepted because of the machine being either empty or out of order, no legal consequences would follow.

Offer, acceptance and the formation of the contract, in the context of automatic machines, were analysed by Lord *Denning* thus:

“... The customer pays his money and gets a ticket. He cannot refuse it. He cannot get his money back. He may protest to the machine, even swear at it. But it will remain unmoved. He is committed beyond recall. He was committed at the very moment when he put his money into the machine. The contract was concluded at that time. It can be translated into offer and acceptance in this way: the offer is made when the proprietor of the machine holds it out as being ready to receive money. The acceptance takes place when the customer puts his money into the slot. The terms of the offer are contained in the notice placed on or near the machine stating what is offered for the money. The customer is bound by those terms as long as they are sufficiently brought to his notice beforehand, but not otherwise. He is not bound by the terms printed on the ticket if they differ from the notice, because the ticket comes too late. The contract has already been made”⁹

¶5-200 Further examples of invitations to treat. The following are further examples of invitations to negotiate:

Tenders. A statement that goods are to be sold by tender is not an offer to sell to the person lodging the highest tender.

— Case example —

The defendants sent out a circular which read, “We are instructed to offer to the wholesale trade for sale by tender the stock in trade of ‘A’ amounting to so and so, and which will be sold at a discount in one lot. Payment to be made in cash.” This was held not to be an offer but a “mere proclamation that the defendants are ready to chaffer for the sale of the goods, and to receive offers for the purchase of them” (per *Willes J* at p 564).

— *Spencer v Harding*¹⁰ —

In the words of Justice Finn:¹¹ “A party calling for tenders may do no more than issue an invitation to treat But equally the steps taken by it

9. *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163 at p 169.

11. *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1 at p 25.

10. (1870) LR 5 CP 561.

may result in the making of contractual commitments in relation to the whole or parts of the tendering process” A tender made in response to a call for tenders is an offer; but does the acceptance of a tender result in a binding contract?

If the tender calls for the supply of a definite quantity of goods or a specific service or services to be performed over a specified period of time, then the acceptance of a tender in response to such a call is one that gives rise to contractual liability. But where the call is for goods that *may* be required over a period of time, as opposed to goods and/or services that *will* be required, then the tender in response is a “standing offer” and acceptance of the tender does not entail a binding contract. All it means is that the offeror *may* require the goods and/or services.

In this situation the offer may be revoked unless a specific requisition for goods or services pursuant to the tender has been made. Each requisition by the offeree constitutes an acceptance for the specific items requisitioned. The offeror can revoke the standing offer at any time and cannot be made liable for further deliveries, but is still bound by requisitions already made.

Announcements. An announcement of an examination for a scholarship has been held not to constitute an offer to award the scholarship to the candidate getting the best marks in the examination.¹²

“Offers”. The fact that a document is called an “offer” is not conclusive. If the person forwarding an “offer” states that legal liability is not intended until it is signed, the document is legally only an invitation to treat awaiting an offer in the form of a signature from the person to whom it is addressed.

Inquiries. A statement made to supply information may not be a definite offer:

— *Case example* —

X: “Will you sell up Bumper Hall Pen? Telegraph lowest cash price.”

Y: “Lowest cash price for Bumper Hall Pen £900.”

X: “We agree to buy Bumper Hall Pen for £900 asked by you. Please send us your title deeds”

Held — no contract. The second telegram was not an offer but only a statement of the price. The third telegram contained the offer which was never accepted.

— *Harvey v Facey*¹³ —

¶5-210 Invitation to treat: auction sales. An auction is a public sale of property by bids, where the sale is concluded with the auctioneer’s acceptance of the last and highest bid. The auctioneer’s call for bids is an invitation to those assembled to bid — it is not an offer.¹⁴ In short:

12. *Rooke v Dawson* [1895] 1 Ch 480.

13. [1893] AC 552.

14. *Payne v Cave* (1789) 3 TR 148; 100 ER 502. If the call for bids were an offer, it would be accepted by the first bid.

- (1) The advertising of an auction does not amount to an offer to sell (§5-200).
- (2) The bid is the contractual offer which can be accepted or refused.
- (3) The contract is complete when the bid is accepted, classically by the fall of the auctioneer's hammer. Until the announcement is made, any bidder can withdraw the bid (§5-360).¹⁵

An auction without reserve indicates that the vendor (or the auctioneer as the vendor's agent) has not fixed a minimum price. If the bid (the offer) is unacceptable, the auctioneer can refuse the bid, the vendor can bid, or the vendor can withdraw the property from sale before a bid is accepted.

Auction disputes may be litigated under the *Trade Practices Act 1974* (Cth) and State/Territory equivalents.¹⁶

§5-212 To whom can an offer be made? An offer can be made to a specific person or persons, or to a class of persons, or to the whole world. It may only be accepted by those for whom it was intended.

— *Case example* —

In *Carlill v Carbolic Smoke Ball Co* (see §5-080) the advertiser raised a number of defences to the plaintiff's claim for the £100 as promised to any user of the advertiser's compound who contracted influenza. In the present context, two more defences were raised: (1) that the terms of the advertisement were too vague to be treated as a definite offer, inasmuch as there was no time limit for catching influenza, and that it could not be supposed that the advertisers seriously meant to promise to pay money to every person who caught influenza after the use of the smoke ball; and (2) that there was such vagueness in the advertisement regarding the persons with whom the contract was intended to be made that it could be seen as "an offer to the world in general".

Each of these contentions was rejected: (1) the terms were quite specific and in fact meant that "£100 will be paid to any person who shall contract the increasing epidemic, influenza, ... after having used the carbolic smoke ball three times daily for two weeks" and (2) it was "... not a contract made with all the world. There is the fallacy of the argument. It is an offer made to all the world; and why should not an offer be made to all the world which is to ripen into a contract with anybody who comes forward and performs the condition?" (per *Bowen LJ* at p 268).

— *Carlill v Carbolic Smoke Ball Co*¹⁷ —

The offer to the whole world was narrowed down to one factor — that it was an offer to become liable to anyone performing the condition. Although the offer was said to be made to the world, a contract would only be made with that specific class of the public coming forward and performing the necessary conditions in reliance on the advertisement.

15. *Vic Goods Act* sec 64(b); *NSW sec* 60(2); *Qld sec* 59(2); *SA, WA sec* 57(2); *Tas sec* 62(2); *ACT sec* 60(3); *NT sec* 60(b).

16. As in *Futuretronics International Pty Ltd v Gadzhis*, §7-280.

17. [1893] 1 QB 256 at p 268.

¶5-215 An offer must be communicated. Unless an offer is communicated to the offeree, there can be no acceptance to form a contract. Hence performance of an act without knowledge of an offer is not acceptance, because the parties acting in isolation have not arrived at any agreement (this is the corollary to the first acceptance rule that acceptance must be in reliance on the offer: ¶5-230). Acceptance of an unauthorised communication of an offer cannot give rise to a contract.

¶5-220 Acceptance of an offer. Once an offer is made, it can be either accepted or rejected. If the parties dispute the existence of a valid acceptance, the rules on acceptance can assist in providing objective tests to be applied to analyse just exactly what took place. The acceptance rules state that:

- (1) Acceptance must be in reliance on the offer (¶5-230).
- (2) Acceptance must be complete and unqualified (¶5-240).
- (3) Conditional assent is not acceptance (¶5-250).
- (4) Acceptance must be clear and certain (¶5-260).
- (5) Acceptance may be express or implied (¶5-270).
- (6) Acceptance may be retrospective (¶5-280).
- (7) A counter-offer is a rejection of an offer (¶5-300).
- (8) Acceptance must be communicated (unless this requirement has been dispensed with, in which case acceptance may be by conduct) (¶5-310).
- (9) The offeror may prescribe the method of acceptance (¶5-320).

¶5-230 Acceptance must be in reliance on the offer. A person purporting to accept an offer must be aware that the offer exists. For example, if B has found A's dog and returns it out of kindness, and if B later learns of a reward offered for the dog, B cannot then claim the reward. The necessary connection between offer and acceptance is missing. Or an offer made to anyone who could swim ashore from the Manly ferry is not accepted if someone falls overboard, swims ashore, and later learns of the offer.

— *Case example* —

A reward was offered by the government of Western Australia of “£1,000 for such information as shall lead to the arrest and conviction of the person or persons who committed the murders” of an inspector and a sergeant of police. The notice also provided for a free pardon to any accomplice, not being the person who actually committed the murders, who should give the information. X and Clarke were arrested and charged with the murders but shortly after Clarke gave information which led to the arrest of Y. X and Y were duly convicted; Clarke, who did not commit the murders, claimed the reward after his release. His claim was unsuccessful on the basis that he gave the information to clear himself of murder and not in reliance upon the reward. In the words of Sir Isaac Isaacs (p 231):

“It is true that without his information and evidence no conviction was probable, but it is also abundantly clear that he was not acting for the sake

of justice or from any impulse of conscience or because he was asked to do so, but simply and solely on his own initiative, to secure his own safety from the hand of the law and altogether irrespective of the proclamation. He has, in my opinion, neither a legal nor a moral claim to the reward."

Further, *Higgins J* noted (p 241):

"Clarke had seen the offer, indeed; but it was not present to his mind — he had forgotten it, and gave no consideration to it, in his intense excitement as to his own danger. There cannot be assent without knowledge of the offer; and ignorance of the offer is the same thing whether it is due to never hearing of it or to forgetting it after hearing."

*R v Clarke*¹⁸

¶5-240 Acceptance must be complete and unqualified. To ensure the "meeting of minds" for the creation of a contract, the law requires acceptance to be complete and unqualified, with nothing further to be negotiated between the parties. Hence, a purported acceptance which introduces new terms is equivocal as it does not conform with the offer. With the use of pre-printed order and contract forms (¶5-780—¶5-790), the pre-printed terms may differ from those in the original offer and difficulties arise as to which terms apply. An acceptance which contradicts the terms of the offer may amount to a counter-offer, which rejects the offer (¶5-300), or it may be conditional, which similarly cannot constitute an acceptance (¶5-250).

Contract law, however, allows for negotiation, and recognises that intention may take different forms and that contracting by its very nature may require many communications between the parties — written, spoken, printed and electronic — before the parties finally reach full agreement. Evidence may show that the purpose of negotiations was to lead to the preparation of a contract of some complexity and in such circumstances the inference may be that the parties did not intend to be bound until signing of the contract. This inference could be displaced by, say, an exchange of faxes indicating intention to be legally bound in advance of formal signing of the contract.

Agreement "in principle" usually mean that the parties have agreed on guidelines for moving the negotiations forward to heads of agreement.¹⁹

¶5-250 Conditional assent is not acceptance. Conditional assent cannot be binding unless and until the offeror agrees to the condition — the condition then has to be fulfilled.

Y may agree to purchase a property from X "subject to bank finance". A person may agree to lease a property "subject to contract". These are conditions precedent and may affect (1) the very formation or the existence of a contract, or (2) the obligation of a party to perform its part of the contract. (These two meanings of condition precedent are discussed at ¶6-060.)

18. (1927) 40 CLR 227.

ANZ ConvR 297, noted (1997) 71 ALJ 117.

19. *Oracle New Zealand Ltd v Price Waterhouse Administration Ltd* (1996)

If bank finance is not approved, the condition precedent is not fulfilled and no contract may be formed. The words "subject to contract" may mean that the parties do not intend to be bound until a written (cf formal: ¶5-040) contract has been prepared. In this situation, even though there may be evidence of agreement on matters which will be subsequently embodied in a contract, the presumption is against contract. However, there is a presumption in favour of contract where the parties are agreed on all matters which in law amount to a concluded agreement and merely intend to execute a written contract in the future.

Suppose X and Y enter an agreement for the sale and purchase of a business and they put the details in writing. The document provides, amongst other things, that "payment of a deposit of ten per cent of the purchase price is to be made upon the execution of a formal agreement" and that "vacant possession is to be given ten days thereafter". There is nothing tentative about this agreement. It is a valid agreement made subject to the fulfilling of two conditions precedent (the deposit and the vacant possession). Non-fulfilment entitles purchaser Y and perhaps vendor X to terminate because of their agreement to discharge the contract by agreement: ¶6-310.

— *Case example* —

A memorandum of sale drawn up by the vendor's agent stated that "[t]his agreement is made subject to the preparation of a formal contract of sale which shall be acceptable to my solicitors on the above terms and conditions and to the giving of possession on or about the Fifteenth Day of March 1952". The purchaser wanted to withdraw from the agreement and alleged that he was not bound to purchase the property. This contention was upheld by the High Court.

Three possibilities were set out by the High Court on the expression "subject to contract":

"Where parties who have been in negotiation reach agreement upon terms of a contractual nature and also agree that the matter of their negotiation shall be dealt with by a formal contract, the case may belong to any of three classes. It may be one in which the parties have reached finality in arranging all the terms of their bargain and intend to be immediately bound to the performance of those terms, but at the same time propose to have the terms restated in a form which will be fuller or more precise but not different in effect. Or, secondly, it may be a case in which the parties have completely agreed upon all the terms of their bargain and intend no departure from or addition to that which their agreed terms express or imply, but nevertheless have made performance of one or more of the terms conditional upon the execution of a formal document. Or, thirdly, the case may be one in which the intention of the parties is not to make a concluded bargain at all, unless and until they execute a formal contract.

In each of the first two cases there is a binding contract: in the first case a contract binding the parties at once to perform the agreed terms whether the contemplated formal document comes into existence or not, and to join (if they have so agreed) in settling and executing the formal document; and in the second case a contract binding the parties to join in bringing the formal contract into existence and then to carry it into execution. Of these two cases the first is the more common ...

Cases of the third class are fundamentally different. They are cases in which the terms of agreement are not intended to have, and therefore do not have, any binding effect of their own ... The question depends upon the intention disclosed by the language the parties have employed, and no special form of words is essential to be used in order that there shall be no contract binding upon the parties before the execution of their agreement in its ultimate shape ... Nor is any formula, such as 'subject to contract', so intractable as always and necessarily to produce that result ... it has been recognized throughout the cases on the topic that such words *prima facie* create an overriding condition, so that what has been agreed upon must be regarded as the intended basis for a future contract and not as constituting a contract."

*Masters v Cameron*²⁰

There is another possible meaning of preliminary agreements such as those "subject to contract" which is now accepted as a fourth category additional to the three set out in *Masters v Cameron*: this is "one in which the parties were content to be bound immediately and exclusively by the terms which they had agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms".²¹ For example, this principle was applied to uphold the validity of an offer to buy which was intended to incorporate an offer to enter into a further agreement.²²

If regulated by the Consumer Credit Code, contracts "subject to finance" may be terminated under sec 124 if finance cannot be obtained: ¶14-220.

¶5-260 Acceptance must be clear and certain. The parties must agree on the exact terms of their contract with sufficient certainty, and if the terms are indefinite there can be no contract. If terms are in the process of being negotiated the contract will be incomplete and unenforceable.

— *Case example* —

An offer for the purchase of a car was accepted "on the understanding that the balance of the purchase price could be had on hire-purchase terms over a period of two years". It was held that no precise meaning could be given to this clause since hire-purchase agreements contained such widely differing terms; consequently there could be no enforceable contract.

*Scammell and Nephew Ltd v Ouston*²³

20. (1954) 91 CLR 353 at pp 360-363; ¶11-440. The parties are bound if their agreement comes within the first class of *Masters v Cameron*, as there is no principle in commercial contracts that where the parties contemplate the signing of a written contract, they do not intend to be bound until then: *Sheehan v Zaszlos* [1995] 2 Qd R 210.

21. *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd* (1986) 40 NSWLR 622 at p 628; appeal upheld (1986) 40 NSWLR 631.

22. *Tern Minerals NL v Kalbara Mining NL* (1990) 3 WAR 486. The offer was not void for uncertainty as it clearly identified the subject of the offer, the price and the parties even though it was "intended to record [the] agreement more fully and formally" in a later contract to be prepared by solicitors.

23. [1941] AC 251; [1941] 1 All ER 14; ¶6-150.

Definite meaning could have been given to this expression had there been previous dealings between the parties or were there an accepted trade usage to which the court could refer to interpret the clause. Because the matter was interpreted as being no further advanced than the negotiation stage, the court was not prepared to make the contract for the parties.

However, *Scammell v Ouston* was not followed in *Meehan v Jones*,²⁴ where “subject to finance on satisfactory terms and conditions” and “subject to finance” were held not to be void for uncertainty, and this was said to be the position in all Australian jurisdictions.

The following is an example of trade usage coming to the rescue of parties to supplement their terms.

— *Case example* —

Timber merchants agreed on 21 May 1930 “to buy 22,000 standards of softwood goods of fair specification over the season 1930” under certain conditions. One condition was an option to buy “100,000 standards of softwood goods of fair specification for delivery during 1931” but the option clause did not specify the precise kind or size of timber to be supplied or the date or method of shipment. The 1930 contract was completed smoothly, but when it came to the 1931 option, the sellers unsuccessfully argued that the option clause was not binding because it was intended merely to form the basis of a future agreement.

— *Hillas & Co Ltd v Arcos Ltd*²⁵ —

This case can be contrasted with *Scammell’s case* on the basis that sufficient intention to be bound could be derived from the option clause and that it could therefore create a valid contract. The exact details could be filled in by reference to the previous dealings between the parties and normal business practice in the timber trade. The language used was on these facts sufficient to bind the parties.

¶5-270 Acceptance may be express or implied. Where many words and/or documents have passed between parties, it may be difficult to fix the time of acceptance; but even if the exact time of acceptance cannot be clearly fixed, agreement may nevertheless be inferred from the conduct of the parties. Unless there is acceptance, specific or implied, there is no contract.

— *Case example* —

P, who had supplied coal to D for many years, requested that a written contract be drawn up between them. A draft contract was forwarded to P, who filled in certain of the blanks, marked the draft “approved”, and returned it to D. Nothing more was done about this draft and, although it was never executed, the parties dealt with each other on the basis of its terms. When a dispute arose between the parties, P refused to supply coal under the draft contract alleging that there was no contract in existence. P’s claim was unsuccessful, because although mere mental assent to the terms of the draft contract was insufficient to create a contract due to non-

24. (1982) 149 CLR 571; (1982) 56 ALJR 813. 25. [1932] All ER Rep 494.

communication of acceptance, and because filling in the blanks could be considered a counter-offer (§5-300), the contract came into existence by conduct either when D sent its first coal order to P in accordance with the terms of the draft contract or at the latest when P supplied coal under that order. In other words, the conduct of the parties subsequent to the draft contract, in accordance with the draft contract, indicated that both parties felt themselves bound by its terms even though no written contract had been entered into.

_____ *Brogden v Metropolitan Railway Company*²⁶ _____

Pinpointing acceptance was not easy in this case: (1) returning the draft was not an acceptance because P had added a new term (the name of the arbitrator); (2) returning the draft with the name inserted could have been interpreted as an offer except that it was never signed/accepted by D and therefore acceptance could not be said to have taken place; and (3) if returning the draft did not qualify as acceptance, the subsequent conduct of the parties indicated the fact of acceptance.

The time of acceptance was left in the alternative by the court as either: (a) when D ordered its first load of coal, or (b) when P first supplied the first load of coal.

§5-280 Acceptance may be retrospective. In the situation where the parties carry out certain acts on the basis that a contract will eventually be made, can later acceptance be retrospective and can it be back-dated to the commencement of the acts of the parties?

In the context of contract law, acceptance is generally capable of operating retrospectively, thereby giving legal effect to everything that has been done under the contract.

— *Case example* —

The parties in question had acted together for some time before the actual execution of a written contract for the construction of a nuclear power station. When a written contract was signed, it was for a price lower than that on which the parties had been proceeding. When one side wanted to withdraw, which price was it entitled to? The court upheld the second (and lower) price because it was the price contained in the later signed written agreement which was held to govern the parties' rights arising from their previous actions.

_____ *Trollope & Colls Ltd v Atomic Power Constructors Ltd*²⁷ _____

§5-300 A counter-offer is a rejection of an offer. The effect of a counter-offer by the offeree is the rejection of the original offer. If the offeree contradicts the terms of the offer, he destroys the terms of the original offer. If he purports to accept the offer on terms additional to those of the offeror, he also may destroy the original offer.

26. (1877) 2 App Cas 666.

27. [1962] 3 All ER 1035.

— Case example —

6 June X offers to sell to Y for £1,000.
 8 June Y, in reply, offers £950.
 27 June Y's offer rejected by X.
 29 June Y offers to pay the original £1,000.

Held: no contract because the letter of 8 June had rejected the original offer which could not now be revived.

*Hyde v Wrench*²⁸

Similarly, where a seller offered to sell subject to its pre-printed terms and conditions, and the buyer offered to buy on its own pre-printed terms and conditions, it was held that the buyer's order was a counter-offer, the acceptance of which by the seller had resulted in a contract on the buyer's terms.²⁹

This does not mean that any communication back to the offeror will operate as a counter-offer in destroying the offer. A distinction must be made between a counter-offer and a request for further information. A request for information may also add a new term to the negotiations without actually being considered to be a counter-offer. The distinction may be a fine one.

— Case example —

Offer of X to Y to sell iron "at 40/- nett cash per ton, open till Monday". Y asked X if X would accept 40/- for delivery over two months. No answer was received, buyer Y did not accept the original offer. In the meantime, X sold the iron to Z and Y sought damages for breach of contract. X's defence was that Y's inquiry was a counter-offer which destroyed X's offer. This argument was rejected:

"the form of the telegram is one of inquiry. It is not 'I offer forty for delivery over two months,' which would have likened the case to *Hyde v Wrench*, where one party offered his estate for £1,000, and the other answered by offering £950. Lord Langdale, in that case, held that after the £950 had been refused, the party offering it could not, by then agreeing to the original proposal, claim the estate, for the negotiation was at an end by the refusal of his counter proposal. Here there is no counter proposal. The words are, 'Please wire whether you would accept forty for delivery over two months, or, if not, the longest limit you would give.' There is nothing specific by way of offer or rejection, but a mere inquiry, which should have been answered and not treated as a rejection of the offer."

*Stevenson, Jacques & Co v McLean*³⁰

¶5-310 Acceptance must be communicated. In general, if acceptance is not communicated to the offeror, there can be no contract

28. (1840) 3 Beav 334; 49 ER 132.

30. (1880) 5 QBD 346, per *Lush J* at p 350.

29. *Butler Machine Tool Co Ltd v Ex-Cell-O Corporation (England) Ltd* [1979] 1 All ER 965.

unless the offeror has expressly or impliedly waived the necessity for communication (§5-270). This would be likely where acceptance is to take place by performance of the promise by the required act, in which case acceptance can be said to have taken place by conduct (such as payment of the first instalment of the council rates, to signify acceptance of the council's offer to permit payment by instalment). However, unless the necessity of communication has been dispensed with, acceptance by silence is no acceptance.

— *Case examples* —

Plaintiff's uncle offered to buy a horse from plaintiff for £30/15/- adding "If I hear no more about him, I consider the horse mine at that price". The plaintiff did not reply to this letter and the question arose as to whether the uncle's letter made good acceptance. It was held that the plaintiff's silence did not amount to acceptance of the offer to buy at £30/15/-.

— *Felthouse v Bindley*³¹ —

Shortly after D's purchase of a building in April, D's agent (property consultant A) contacted P (architects and project managers) to report on building redevelopment. P prepared plans, drawings and council application, but because "[D] does not sign contracts", no printed Master Builders' Association (MBA) contract was signed by D. Preliminary site preparation commenced in May, and D made the first progress payment in September. After P received the council building permit, P sent D two copies of the printed MBA contract and commenced demolition ready for building. P wrote to A on 3 October "With reference to our letter ... [containing the printed MBA contract], concerning the return of the signed contracts we are proceeding on the understanding that the conditions of the contract are accepted by you [ie D] and works are being conducted in accordance with those terms and conditions." Building work proceeded normally but only \$45,000 of \$111,000 was paid for a progress claim in March of the following year. (A further \$20,000 would have been needed to finish the project.) In legal proceedings by P to enforce payment, D denied liability under the letter of 3 October on the basis that silence and inactivity do not constitute assent and that therefore P could not bind D to deny P's assumption that a contract existed in the form of the printed MBA contract. Confirming both *Brogden's case* (§5-270) and *Felthouse v Bindley* (above) and upholding P's claim for \$83,500, the New South Wales Court of Appeal found D had accepted P's printed MBA contract forwarded with its letter on 3 October:

1. Although silence is seen as rejection of an offer, the offeree's communication of acceptance is not always necessary. In some circumstances (such as in this case), the offeree (D) may be under a duty to communicate to the offeror (P) rejection of an offer.
2. Although the offeror cannot assert that it will regard silence as acceptance, where there is a duty to communicate to the offeror, silence will generally be regarded as an acceptance of the offer sufficient to form a contract.

— *Empirnall Holdings Pty Ltd v Machon Paull Partners Pty Ltd*³² —

31. (1862) 11 CB (NS) 869; 142 ER 1037.

32. (1988) 14 NSWLR 523, noted (1989) 63 ALJ 642.

A commercial agreement for the rental of equipment provided that the agreement would be "automatically renewed" after one year's hire. The court confirmed that an option can be exercised by a negative act such as by this non-action by the hirer.

————— *Nortel Australia Pty Ltd v Portfolio Leasing Australia Ltd*³³ ———

D sent P a cheque, stating that it could only be accepted on the basis that it was in full and final satisfaction of all claims or else it must be returned. When P banked the cheque, no contract was formed "because in general the law does not allow the imposition of an obligation in contract to be achieved by a stipulation that it shall be deemed to be imposed if the prospective obligor performs a stipulated act (other than one by way of express assent to the terms proposed), or does nothing as in *Felthouse v. Bindley*". P was still able to claim the balance.

————— *McMahon's (Transport) Pty Ltd v Ebbage*³⁴ ———

In some circumstances a contract can be formed by a silent offer accepted silently.

An offeree does not have to go to the trouble of rejecting an offer. Similarly, the recipient of unsolicited goods sent through the mail or left at the front door cannot be forced into a contract by the sender stating that unless word is received to the contrary by a certain date, the sender will assume the goods to be bought. Instead, the burden is on the offeror to ensure that an acceptance is communicated and to ensure that the offeror has not waived the necessity of communication of acceptance. The receipt of unsolicited goods is now generally governed by legislation.³⁵

In the *Carbolic Smoke Ball case* (¶5-080; ¶5-212), it was held that the offeror had dispensed with the need to communicate acceptance of the offer because the offer was published in a newspaper. Performance of a condition of the offer was sufficient acceptance of the offer. An offeror's letter may dispense with the need for communication of acceptance and its offer may be accepted by the offeree acting on the letter.

If there is no such dispensing with the need to communicate acceptance, there must be communication of acceptance to the offeror. Rumours of acceptance, leaks and the like are no acceptance.

— *Case example* —————

The school managers resolved to appoint X to the headmastership, but they did not officially communicate their resolution to him even though one of the school managers told X privately of the decision. When another candidate was selected in place of X, X sued the chairman of the school managers for breach of contract. His action failed on the basis that there was no contract

33. (1998) 8 BPR 15,857, noted (1998) 72 ALJ 355.

34. [1999] 1 Qd R 185; ¶6-310.

35. *Trade Practices Act 1974* (Cth) sec 64, 65 (unsolicited goods) and equivalents: ¶7-490. The law does impose obligations on the involuntary bailee (¶15-060).

between the parties, as the school managers' acceptance of X's offer of services had never been communicated to him.

It was held that the mere fact that the managers did not authorise communication implied that they meant to reserve the power to reconsider their decision, as they did to the detriment of X. In other words, all the best intentions of acceptance come to nothing if left unsaid: mental assent or even actions indicating an intention to accept do not of themselves constitute acceptance.

Powell v Lee³⁶

The communication necessary to make up a valid acceptance may be express (correspondence, meeting, discussion, etc) or it may be inferred by the conduct of the offeree. Determining whether there is an acceptance in response to an offer to give rise to a contract may not be easy (§5-270).

§5-320 The offeror may prescribe the method of acceptance. The terms of the offer may prescribe the method of acceptance; if so, acceptance must comply with the requirements before an agreement is completed. Difficulties can arise on the question of whether acceptance sufficiently complies with the terms of the offer.

- There is a presumption that if no method of acceptance is prescribed, acceptance is to take the same form as the offer.
- An offer by telegram creates the presumption that an equally prompt reply is required, and that subsequent acceptance by post may fail for non-compliance with the offer.³⁷
- If the offeror requires a reply "by return post", the offeree can reply by courier, phone, etc if exact compliance is not specified as the only means of acceptance. However, if a delay occurs, the risk of delay is on the offeree.³⁸
- If the offeror stipulates that acceptance must be in a certain form and that no other method of acceptance (verbal or written) would be valid, non-compliance with the exact method would constitute failure of acceptance.
- Where the communication between the parties is instantaneous (such as person-to-person, telephone or telex), acceptance must be received by the offeror to conclude the agreement:

Case example: instantaneous communication

An agreement by means of telex was entered into between the plaintiff in London and the defendants in Amsterdam. When the contract was broken, the question arose of where the contract was made: was litigation to commence

36. (1908) 99 LT 284.

37. *Quenerduaine v Cole* (1883) 32 WR 185.

38. *Tinn v Hoffman & Co* (1873) 29 LT 271;
Eliason v Henshaw (1819) 4 Wheaton 225.

in the English or in the Dutch courts? It was held that where there was instantaneous communication the contract was made when and where the acceptance was received, in this case London. This rule was set out by *Denning LJ* in the following words:

“Suppose, for instance that I make an offer to a man by telephone and, in the middle of his reply, the line goes ‘dead’ so that I do not hear his words of acceptance. There is no contract at that moment. The other man may not know the precise moment when the line failed. But he will know that the telephone conversation was abruptly broken off: because people usually say something to signify the end of the conversation. If he wishes to make a contract, he must therefore get through again so as to make sure that I heard. Suppose next, that the line does not go ‘dead’, but it is nevertheless so indistinct that I do not catch what he says and I ask him to repeat it. He then repeats it and I hear his acceptance. The contract is made, not on the first time when I do not hear, but only the second time when I do hear. If he does not repeat it, there is no contract. The contract is only complete when I have his answer accepting the offer ...

My conclusion is that the rule about instantaneous communications between the parties is different from the rule about the post. The contract is only complete when the acceptance is received by the offeror: and the contract is made at the place where the acceptance is received.”

— *Entores Ltd v Miles Far East Corporation*³⁹ —

Acceptance by fax. The instantaneous communication rule applies equally to communications by facsimile — there is no contract if a faxed acceptance is not received. The contract is made at the time and place of receipt of the acceptance by the offeror. There is no receipt of acceptance if:

- (1) the fax is received by clerical staff who have no authority to bind their principal — there can be no acceptance until received by the principal;
- (2) the fax machine is turned off, especially as some faxes are sent out of hours.⁴⁰

Risk of loss from non-receipt of fax should lie with the party who chose the fax as the means of communication, and later confirmation would be wise.

Acceptance by e-mail. A message is deemed to have been mailed by e-mail when sent, but the offeree’s acceptance by e-mail is not received until the offeror has logged into the system. Unless the offeror has logged into the system, e-mail is not a form of instantaneous communication. Logging in is the equivalent of opening the mail.

¶5-330 The postal acceptance rule. A major exception to the rule that acceptance must be communicated (¶5-310—¶5-320) is the postal acceptance rule:⁴¹

39. [1955] 2 QB 327 at pp 332-334; [1955] 2 All ER 493 at pp 495-496.

law and the electronic marvels (1994) 2 Current Commercial Law 47.

40. *The facsimile machine* (1992) 66 ALJ 326; Gardiner, J, *The postal rule in contract*

41. *Henthorn v Fraser* [1892] 2 Ch 27 at p 33.

“Where the circumstances are such that it must have been within the contemplation of the parties that, according to the ordinary usages of mankind, the post might be used as a means of communicating the acceptance of an offer, the acceptance is complete as soon as it is posted.”

So long as the letter is properly pre-paid and addressed, and deposited in the post, a contract is formed on posting (not on cancellation of the stamp) even if the offeror is unaware of the posting or the letter is lost in the post or is never delivered.

— *Case example* —

Offer posted 2 September which asked for a reply “in course of post” was misdirected because of the wrong address and did not reach offeree until 5 September. Letter of acceptance posted 5 September which reached offeror 9 September. If the offer had not been misdirected, offeror could have expected a reply on 7 September, and believing no reply, sold the goods to a third party on 8 September. Offeree was successful in action for breach of contract on the basis that the contract was concluded when the letter of acceptance was posted, ie 5 September. In this case, the offeror’s mistake was held against him and for the purposes of the contract the offeree’s letter was indeed received “in course of post”.

— *Adams v Lindsell*⁴² —

The postal acceptance rule generally operates to the benefit of the offeree, the party posting the acceptance. A strict application of the postal acceptance rule would prevent recall of a letter of acceptance because the contract is complete when the letter is posted. The present position remains that when acceptance has been made by post, it cannot be revoked by post even if the acceptance has not yet been communicated to the offeror.

The postal acceptance rule is an exception to the normal rule that acceptance must be communicated. Hence, an offer may exclude the operation of the postal acceptance rule by requiring actual communication of acceptance before a contract is created:

- (1) For example, a land contract does not normally come into existence until exchange of signed counterparts of the contract by the vendor and the purchaser (§3-450). This is not the date of posting the counterpart, but the date of the exchange of contracts.⁴³
- (2) In view of periodic unreliability in the postal service, an offer may be expressed so as to exclude the operation of the rule by requiring actual communication of acceptance: “Acceptance shall be deemed not to have taken place until it is received at this office”; “Payments must be received by the Due Date”.

42. (1818) 1 B & Ald 681; 106 ER 250; *Household Fire and Carriage Accident Insurance Co Ltd v Grant*, ¶17-200.

43. *Nunin Holdings Pty Ltd v Tullamarine Estates Pty Ltd* [1994] 1 VR 74, noted

Khoury, D, *Alive and still kicking — the postal acceptance rule* (1995) 69 LIJ 239.

- (3) As well, there has been some statutory modification to the general rule. In consumer credit legislation, a “document sent by post ... [is taken to be given] on the date ... when it would have been delivered in the ordinary course of post”.⁴⁴

— *Case example* —

A clause in a lease which required the exercise of an option to renew the lease to be by “registered or certified letter” excluded the operation of the postal acceptance rule: the option could not be exercised by posting a letter in the ordinary mail.

— *Elizabeth City Centre Pty Ltd v Corralyn Pty Ltd*⁴⁵ —

¶5-350 Termination of offer. An offer once made can be terminated by various means to prevent acceptance by the offeree:

- (1) revocation (¶5-360);
- (2) lapse of time (¶5-370);
- (3) non-occurrence of a necessary condition (¶5-380);
- (4) death (¶5-390).

Termination of the *offer* should not be confused with termination of the *contract*, which is dealt with in Chapter 6 (¶6-280—¶6-370).

¶5-360 Revocation. An offer may be revoked or cancelled at any time before acceptance. To be effective, revocation must be communicated to the offeree before the offeree has accepted the offer.

— *Case example* —

1 October	.....	letter of offer posted
8 October	.....	letter of revocation posted
11 October	.....	letter of offer received
11 October	.....	telegraph of acceptance posted
15 October	.....	letter of acceptance posted to confirm telegraph
20 October	.....	letter of revocation received

It was held that the contract was completed on 11 October with the posting of the telegraph of acceptance. The applicable principles were set out by *Lindley J* in the following words:

“It may be taken as now settled that where an offer is made and accepted by letters sent through the post, the contract is completed the moment the letter accepting the offer is posted ... even although it never reaches its destination. When, however, [the] authorities are looked at, it will be seen that they are based upon the principle that the writer of the offer has expressly or impliedly assented to treat an answer to him by a letter duly

44. Consumer Credit Code sec 173(1)(b). Similarly, interpretation legislation states that “service by post” is deemed to have

been effected when the letter would be delivered in the ordinary course of post.

45. (1995) 63 SASR 235.

posted as a sufficient acceptance and notification to himself, or, in other words, he has made the post office his agent to receive the acceptance and notification of it. But this principle appears to me to be inapplicable to the case of the withdrawal of an offer. In this particular case I can find no evidence of any authority in fact given by the plaintiffs to the defendants to notify a withdrawal of their offer by merely posting a letter ... it may be as well to point out the extreme injustice and inconvenience which any other conclusion would produce. If the defendants' contention were to prevail no person who had received an offer by post and had accepted it would know his position until he had waited such a time as to be quite sure that a letter withdrawing the offer had not been posted before his acceptance of it. It appears to me that both legal principles, and practical convenience require that a person who has accepted an offer not known to him to have been revoked, shall be in a position safely to act upon the footing that the offer and acceptance constitute a contract binding on both parties."

Byrne & Co v Van Tienhoven⁴⁶

The communication necessary for a valid revocation can either be made directly by the offeror, or it can reach the offeree through another reliable source.

— *Case example* —

On 10 June, D offered to sell property to P by letter stating "This offer to be left over until Friday 9 o'clock AM, 12th June". On Thursday 11 June D sold the property to Allen and that afternoon P was told by Berry that D had sold the property to Allen. Before 9 am on 12 June, P's agent handed D a formal letter of acceptance.

The court held that revocation of the offer had been communicated to P when Berry notified him of D's dealings with Allen, and this was in effect a communication of D's revocation.

*Dickinson v Dodds*⁴⁷

It was P's knowledge of the prior sale of the property that was crucial in this case, but it leads to the practical difficulty of defining what means of communication of revocation will actually suffice to prevent acceptance by the offeree. Will a rumour or mere gossip suffice? The only answer is what is reasonable in the circumstances. Hence a suspicion on the part of the vendor that the purchaser intends to revoke an offer does not constitute evidence of revocation of offer and is no substitute for actual communication of revocation of offer.

Withdrawing an acceptance by post. Revocation of an offer must be communicated to the offeree, and if revocation is by post, the risk of non-delivery of the letter is on the offeror. (Similarly, the risk of non-delivery of the offeree's acceptance of an offer by post is on the offeror if the offeror has specified acceptance by post: ¶5-330.)

46. (1880) LR 5 CPD 344 at pp 348-349.

47. (1876) 2 Ch D 463.

Because a postal acceptance is effective when posted by the offeree, an attempt to revoke it with a communication which overtakes it will not be effective, even if the revocation is received before the acceptance. The offeree's revocation comes after the postal acceptance.

If the offeror has received what appears to be a rejection of its offer, the offeror is free to deal with the subject as it wishes and can disregard any claim by the offeree.

¶5-365 Revocation and option. Revocation of an offer before its acceptance does not involve the offeror in legal liability. But if there is a promise by the offeror to keep the offer open for a fixed period and that promise is supported by consideration, then a subsidiary contract, called an option, may be considered to have arisen. (See also ¶3-250.) More formally stated, an option is a legal right acquired by contract by one party from the other to enter into a specified transaction within the period specified in the option agreement: "in consideration of \$1, I promise to keep open for seven days my offer to sell you my widget for \$100."

— *Case example* —

A clause in a lease of a dairy farm fronting the Brisbane River under which the lessee might "offer to purchase the demised land from the lessor for the consideration equal to one thousand dollars (\$1,000) per acre" during or "at the expiration of" the lease was construed not as creating a meaningless power to make an offer (which the lessee would have had at any time) but as creating an option to purchase.

— *Watson v Phipps*⁴⁸ —

Options to purchase shares and other securities (call options) and options to sell shares and other securities (put options) can be traded in securities markets and, as exchange traded options, are regulated by securities law.⁴⁹ The option premium is the consideration paid for the option; the strike price or the exercise price is the price specified in the option and the time specified ends on the expiry date or the exercise date.

Exercise of an option must comply strictly with the terms of the option.

— *Case example* —

An option to purchase stated that "[t]his Option shall be exercised by notice in writing ... delivered personally to or sent by prepaid letter post to the Owner .. at any time prior to the expiration of this Option ... if sent by post [it] shall be deemed to be delivered in due course of post". A notice in writing with a cheque for the specified sum was sent by registered mail on the expiry date, but was received by the owner in the ordinary mail on the following day. The court held that payment of the price was a condition of the exercise of the option, that "sent by post" meant when delivered, and

48. (1986) 60 ALJR 1, noted (1986) 60 ALJ 476.

49. As defined in the Corporations Law sec 9 "option contract".

even though a photocopy of the notice and of the cheque had been delivered by hand on the expiry day, there had not been a valid exercise of option.

— *Lewes Nominees Pty Ltd v Strang*⁵⁰ —

There is considerable academic and judicial discussion on whether options are properly characterised as irrevocable offers or as conditional contracts. This is determined by the construction of the option agreement, and only rarely will it make any difference to the validity or the enforcement of an option.⁵¹

¶5-370 Lapse of time. In most business matters, time is crucial. If an offer has not been accepted reasonably promptly, it may be difficult to decide whether it is fair to assume the offer is still open.

— *Case example* —

D applied for shares and paid a deposit on 8 June (ie offer) but no allotment was made until 23 November when D was informed that the shares had been allotted to him (ie acceptance) and that the balance on them was due. When the company (P) tried to enforce the allotment by claiming that a valid contract had been made, D's defence that his offer had terminated through lapse or passage of time was upheld. D's offer had not been accepted within a reasonable time.

— *Ramsgate Victoria Hotel Co Ltd v Montefiore*⁵² —

¶5-380 Non-occurrence of a necessary condition. An offer may also lapse when a condition to which it is subject is not fulfilled. For example, an offer to buy goods must be read subject to the implied condition that the goods will remain in substantially the same state as when the offer was made. If the goods are seriously damaged, or if there is any real change in the subject of the contract after the offer is made, the offer is terminated by this change. If finance is not obtained in a contract for the purchase of real estate "subject to finance", the offer of the purchaser lapses for non-fulfilment of a necessary precondition.

¶5-390 Death. Agreement is impossible following the death of offeror or offeree. An offer cannot normally be accepted after the death of the offeror. If there is a personal element in the offer, the offer cannot be accepted because performance by the deceased offeror is impossible. However, acceptance may still be possible and the estate of the deceased offeror therefore bound in some circumstances.

— *Case example* —

Where an offeror agreed to act as guarantor for a loan for his son, the creditor was able to enforce the guarantee against the deceased offeror/

50. (1983) 57 ALJR 823, noted (1984) 58 ALJ 233; contrast (1986) 60 ALJ 237.

52. (1866) LR 1 Exch 109.

51. *Ballas v Theophilus (No 2)* (1958) 98 CLR 193, per *Williams J* at p 207.

guarantor's estate because the continued existence of the offer was not dependent on the life of the guarantor but on the continuation of the son's credit arrangement.

_____*Bradbury v Morgan*¹ _____

The death of the offeree would similarly terminate the negotiations unless the offeror intended to make the offer either to the offeree or to his executors,² or in the clearest circumstances, if he intended the offer to go to the public at large in which case the death of an individual offeree would be of no consequence.

CONSIDERATION _____

Consideration is required for a legally binding promise	¶5-400
Consideration may be "executed" or "executory" but cannot be "past"	¶5-410
Executory consideration	¶5-420
Executed consideration	¶5-430
Consideration need not be adequate	¶5-440
Consideration must be sufficient	¶5-450
Insufficiency of consideration: performance of a public duty owed by law	¶5-460
Insufficiency of consideration: duty already imposed by contract	¶5-470
The rule in <i>Pinnel's case</i>	¶5-480
Promissory estoppel	¶5-485
Insufficiency of consideration: part payment from third party	¶5-490
Insufficiency of consideration: composition with creditors	¶5-495
Insufficiency of consideration: moral obligation	¶5-497
Insufficiency of consideration: illusory or uncertain promises	¶5-498
Consideration must move from the promisee	¶5-500

¶5-400 • Consideration is required for a legally binding promise. After intention to create legal relations (¶5-050—¶5-120) and offer and acceptance (¶5-130—¶5-390), the third essential condition for the creation of a valid contract is consideration. **Consideration is an aspect of the concept of mutuality underlying the law of contract.** Most modern contracts consist of a bargain which is arrived at by an exchange of promises, each of which is assumed to be equally binding.

1. (1862) 1 H & C 249; 158 ER 877.

2. *Reynolds v Atherton* (1921) 125 LT 690.

If X says to Y “I will give you \$100” and Y says “Thank you”, there is clearly an agreement but it is not legally enforceable. Not only is there possibly no intention to create legal relations, but also Y has given no consideration to support X’s promise. X’s promise remains gratuitous, unsupported by consideration. If instead, in addition to saying to Y “I will give you \$100”, X writes “I solemnly swear to pay Y \$100”, and even if Y writes underneath “I agree”, there is still no agreement legally enforceable by Y because Y has still done nothing. X’s promise remains unsupported by consideration.

Consideration can be viewed as price, and the common law requires a price to be paid for every promise before that promise will be legally enforceable. A gratuitous promise is not enforceable. A classic definition of consideration is from *Currie v Misa*, 1875: “... A valuable consideration, in the sense of the law, may consist either in some right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility given, suffered, or undertaken by the other.”³

This was adapted by Sir Frederick Pollock: “... [a]n act or forbearance of the one party, present or promised, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable.”⁴

The requirement of consideration emphasises the essentially commercial nature of the simple contract in demanding evidence of a bargain. Consideration refers to nothing more than “something for something”.

Examples of consideration

Mutual promises: A promises to work for B in return for B’s promise to pay A.

Mutual promise: A promises to marry B and B promises to marry A. Each promise is the consideration for the promise of the other.

A promise in return for an act: A promises to pay B for certain work in the future by B. B’s carrying out of the work is B’s consideration for A’s promise.

A says to B, “If you buy a yacht from moneys due to you on your 21st birthday, I will buy you a trailer for the yacht for your birthday”. B buys the yacht, which is his act in consideration for A’s promise.

C withdraws proceedings against A in consideration of B’s promise to pay A’s debts.

C agrees to act as A’s attorney in consideration of B’s promise to pay A’s debts.

Coming to a supermarket to shop — or buying goods there — is the shopper’s consideration to create a contract with the supermarket for the use of a shopping trolley.⁵

3. (1875) LR 10 Ex 153, per *Lush J* at p 162.

4. Pollock, F, *Principles of Contract*, Stevens and Sons, 3rd ed, 1881, p 179.

5. *Cottee v Franklins Self-Serve Pty Ltd* [1997] 1 Qd R 469; the contract is a contract of bailment: ¶15-180.

Examples of no consideration

A promise in return for an act: A promises B a yacht for his 21st birthday. In anticipation, B buys a trailer for it. B's act is not consideration for A's promise. B promised neither A nor anyone else anything in return.

— Case example: no consideration —

A bank (P) obtained a new and larger contract of guarantee (¶13-360) to support a higher loan to D (the guarantor, an existing customer) to replace D's existing overdrawn contract of guarantee "in consideration of the Bank ... forbearing to enforce immediate payment of moneys (if any) now due and owing by the customer to the Bank".

D's new promise in the new guarantee was held to be unenforceable as P had given no consideration to support D's new promise:

- (1) P had given no forbearance to sue — no demand had been made by P for repayment of the existing debt by D and no request had been made by D for any such forbearance.
- (2) P had provided no extra finance to support D's promise.

The fact that P provided "banking accommodation" which permitted D to continue to maintain its account in debit while getting its affairs in order was a postponement of a creditor's right to call in a debt, not valuable consideration.

McKay v National Australia Bank Ltd⁶

By the sixteenth century the English courts had established that the mere declaration of will (a bare promise) was of no legal effect unless supported by good reason, good motive, or in other words good consideration. Legal enforceability of a promise therefore depended on the reason for the promise, and the reason for the promise became the reason why it should or should not be enforced. The following rules set out the operation of the doctrine of consideration:

- (1) Consideration is required for a legally binding promise.
- (2) Consideration may be "executed" or "executory" but cannot be "past" (¶5-410—¶5-430).
- (3) Consideration need not be adequate (¶5-440).
- (4) Consideration must be sufficient (¶5-450—¶5-498).
- (5) Consideration must move from the promisee but need not move to the promisor (¶5-500).

If there is "failure of consideration", there is no consideration by the promisee to support the promise of the promisor. For example, there is failure of consideration if the promisor has paid money or provided consideration and has received nothing for it or if the goods to be paid for are not delivered. The failure of performance determines whether there has

6. [1988] 1 VR 173, noted (1998) 13 BLB 137.

been a failure of consideration, not the failure of the promise — otherwise there could never be a total failure of consideration if both parties have promised to carry out their parts of the agreement.

There is no failure of consideration if the contract has been performed in part. There is only failure of consideration if the benefit bargained for has been totally lost.⁷ For example, the purchaser of an unprofitable business cannot claim a refund based on failure of consideration if the loss is caused by a bad bargain (the unprofitability of the business), not the failure of consideration.⁸

The doctrine of consideration has the capacity to render an agreement unenforceable on basically technical grounds and it has been criticised by commentators.⁹ To the rigidities of the doctrine of consideration the law has responded in at least two ways: (1) the development of promissory estoppel may hold a party to its promise even in the absence of consideration (§5-485), and (2) sec 51A, 52 and 53 of the *Trade Practices Act 1974* (Cth) renders misleading or deceptive conduct, and false representations, legally actionable — with or without consideration (within the scope of the Act's operation: §5-010).

§5-410 Consideration may be “executed” or “executory” but cannot be “past”. One rule of consideration states that consideration may be “executed” or “executory” (§5-420 — §5-430), but not “past”. Past consideration is no consideration.¹⁰ If A promises to pay B for certain work already done by B, B cannot enforce A's promise because B has already done the work. B has nothing to offer by way of consideration to support A's promise. The concept of past consideration is really a misnomer, as there can be no contractual relationship established after the act of one party has already been performed.

Suppose that Y has been a long term employee of X, and in return for his many years of outstanding service, X promises him a free trip to Hawaii. If X fails to honour the promise, Y will have no recourse because he has nothing to offer by way of consideration to support X's promise.

If the trip was expressed to be in consideration of Y's agreement not to take a gold watch legally due to him on retirement, the position would be different because Y would then be in a position to offer something (a right or interest) in consideration for X's promise (a detriment or responsibility given).

7. eg *Baltic Shipping Company “The Mikhail Lermontov” v Dillon* (1993) 176 CLR 344 at pp 389, 391; §6-220.

8. *Newitt v Leitch* (1997) 6 Tas R 396.

9. eg Ellinghaus, MP, *Consideration reconsidered* (1975) 10 MULR 267.

10. Subject to the exception contained in the *Cheques Act 1986* (Cth) sec 35 which says that “[v]aluable consideration for a cheque [or payment order] may be constituted by ... an antecedent debt or liability” (§16-360).

— *Case examples* —

Braithwait had killed Mahume and, at Braithwait's request, P endeavoured to obtain a pardon from the King. In doing so, P incurred expenses involved in "many days labour" and "riding and journeying to and from London and Newmarket". Having obtained a pardon, Braithwait afterwards promised to pay P £100 for his trouble, a promise which Braithwait later broke. When sued by P on the promise, one of Braithwait's defences was that his promise to pay was not supported by consideration from P (ie past consideration is no consideration). This contention was rejected on the grounds that P did not spontaneously provide the services but did so in response to Braithwait's request:

"It was agreed that a mere voluntary courtesie will not have a consideration to uphold an assumpsit. But if that courtesie were moved by a suit or request of the party that gives the assumpsit, it will bind, for the promise, though it follows, yet it is not naked, but couples itself with the suit before ..."

*Lampleigh v Braithwait*¹¹ —

Two patent owners wrote to their manager and said, "We now have pleasure in stating that in consideration of your services as the practical manager in working both our patents as above for transit by steam or for any land purposes we hereby agree to give you one-third share of the patents abovementioned." In other words, in consideration of his efforts in promoting the invention in question, the manager was being offered a share of the profits. After the death of one patent owner, his executors claimed delivery up of the letters patent arguing there was no consideration (from the manager) for the assignment of the one-third share. This argument was unsuccessful.

*In re Casey's Patents, Stewart v Casey*¹² —

This case indicates one way around the past consideration rule. It was said that the previous request to render the services raised an implied promise to pay. The manager would not have agreed to promote the patents in the first place unless he knew he was to be paid, and in fact all the letter in question did was to fix the remuneration for the manager's services on the faith of which the services were originally rendered. The past services and the present promise could therefore be tied into the one enforceable undertaking.

— *Case examples* —

Under the main agreement, P sold shares in P Pty Ltd to D in consideration of a parcel of shares in D Ltd and certain promises, and a subsidiary buy-back agreement from D (as a guarantee against a fall in the price of the shares in D Ltd). Realising that the buy-back agreement was not really to P's advantage, P pressured D to cancel the subsidiary agreement and replace it with a full indemnity agreement to guarantee the price of the shares. The guarantee (the new subsidiary agreement) incorporated as part of the stated consideration the promise of P in the main contract. The shares in D Ltd

11. (1615) Hob 105; 80 ER 255; Stoljar, SJ, *The consideration of request* (1966) 5 MULR 314. 12. [1892] 1 Ch 104.

having fallen in value, P claimed the value of the indemnity from D. By way of defence, D raised (among other matters including economic duress: ¶5-720) that the expressed consideration for D's promise to indemnify P was past consideration because P was already under a legally enforceable obligation to complete the main contract. This view was rejected by the Privy Council. The legal principles were stated in the following words:

"An act done before the giving of a promise to make a payment or to confer some other benefit can sometimes be consideration for the promise. The act must have been done at the promisor's request, the parties must have understood that the act was to be remunerated either by a payment or the conferment of some other benefit, and payment, or the conferment of a benefit, must have been legally enforceable had it been promised in advance. All three features are present in this case."

*Pao On v Lau Yiu Long*¹³ —

R bought T's horse and after the sale T promised that the horse was sound and free from vice. In fact the horse proved unsuitable — "vicious, restive, ungovernable or ferocious in manner, etc". Because the warranty (promise) was made after the sale, R had given no consideration to enforce it except the past consideration of the sale.

*Roscorla v Thomas*¹⁴ —

¶5-420 Executory consideration. This expression refers to the situation where X's promise is made in return for a counter-promise of Y, ie where a promise is made by one party in return for a promise of the other, each promise being consideration for the other.

When consideration is executory, the contract is effective as soon as the promises are exchanged; they do not have to have been performed. Examples would be those given in ¶5-400 of mutual promises (a promise to work) or of a promise in return for an act (a promise to pay for work to be performed). Where consideration is executory, liability is outstanding on the part of both parties.

¶5-430 Executed consideration. Where an act has been performed in return for a promise, consideration is said to be executed. If A offers \$5 to anyone returning A's lost dog, the return of the dog by B is both acceptance of the offer and performance of the act which makes up the required consideration. A's promise remains outstanding as B has performed B's part and, where B's consideration is executed, liability is outstanding on A's part only.

¶5-440 Consideration need not be adequate. Whether the parties enter into a poor deal or not (eg the sale of property at a giveaway price) does not concern the law because consideration need not be adequate, as long as there is at least some consideration present. "Good" consideration to support a simple contract at common law can be nominal or trivial; it can

13. [1980] AC 614 at p 615; [1979] 3 All ER 65 at p 66. 14. (1842) 3 QB 234; 114 ER 496.

be real and substantial; it need not be at commercial rates.¹⁵ However, it must be sufficient, and this means that it must have some legal value — see ¶5-450.

The law leaves the parties free to make their own bargain and the validity of a contract is not affected by a bad bargain.¹⁶ Even acts or omissions of a trivial nature may make up sufficient consideration to support a simple contract. For instance, there are still real-life examples of houses, schools and even city buildings leased at rent of one peppercorn per year (“peppercorn rental”).

— *Case example* —

As part of an advertising campaign, records were to be sold to the public for one shilling and sixpence plus three wrappers from Nestlé’s products. The copyright holder claimed its royalty of 6¼% of “the ordinary retail selling price” and the question to be decided was whether royalties were owing on one shilling and sixpence or on one shilling and sixpence plus the value of the three wrappers (which of themselves were of no value and in fact were thrown away). Royalties were held to be payable on the larger amount: “A contracting party can stipulate for what consideration he chooses. A peppercorn does not cease to be good consideration if it is established that the promisee does not like pepper and will throw away the corn.”

_____ *Chappell & Co Ltd v Nestlé Co Ltd*¹⁷ _____

“I will give you my old car if you tow it away” can become enforceable because of the “detriment” suffered by the promisee.

A promise to give away shares which were not fully paid up would be binding if the promisee undertook to pay outstanding calls.

Forbearance to sue. A promisee’s promise to settle a disputed claim and not sue, if given at the request of the promisor, is adequate consideration for a matching promise by a promisor. The claim on which the promisee’s action is based must be reasonable, and the promisee must honestly believe in its chances of success. For example, a statement by the defendant insurer (the promisor) that “[i]t is confirmed that liability is not an issue” was an implied request to the plaintiff to forbear from taking further action. The statement was therefore contractual and binding on the promisor.¹⁸

¶5-450 Consideration must be sufficient. Adequacy and sufficiency of consideration are not the same. The concept of sufficiency raises the question of whether an act is consideration at all. For example,

15. But a transfer of property, by a person who later becomes a bankrupt, up to five years before bankruptcy is void against the trustee if the transferee gives no consideration or consideration less than the market value of the property concerned, as at the time of the transfer (*Bankruptcy Act 1966* (Cth) sec 120: ¶13-670).

16. The validity of a contract may be challenged, for example if there is evidence

of mistake (¶5-620), misrepresentation (¶5-700), undue influence (¶5-710), duress (¶5-720), unconscionability (¶5-730) or misleading or deceptive conduct (¶7-250).

17. [1960] AC 87, per Lord Somervell at p 114.

18. *Newton, Bellamy and Wolfe v State Government Insurance Office (Qld)* [1986] 1 Qd R 431; discussed in Smith, DW, *The “admission” before action may be a binding contract* (1990) 12 LSB 70.

indefinite consideration lacks sufficiency and has no value in the eyes of the law.

Insufficient consideration can be analysed under the following headings:

- (1) Performance of a public duty imposed by law (§5-460). 301
- (2) Performance of a duty already imposed by contract (§5-470). 302
- (3) Acceptance by the creditor of part payment by a third party (§5-490). 310
- (4) Composition with creditors (§5-495). 311
- (5) Moral obligation (§5-497). 311
- (6) Illusory or uncertain promises (§5-498). 312

To carry out an existing legal obligation — as in classes (1) to (4) — is insufficient consideration for a new contract to do the same thing, and a new contract will fail under the “pre-existing duty” rule.

§5-460 Insufficiency of consideration: performance of a public duty owed by law. The discharge of a duty which a person is obliged by law to perform is no consideration for a promise made in exchange for that performance. For example, and subject to entitlement to payment of expenses as provided for under the relevant Rules of Court, a person subpoenaed to attend court as a witness cannot sue on a promise of payment for attendance. Because such attendance is a requirement imposed by law, a promise of remuneration for so attending is a promise made without consideration.¹⁹

Only if the promisee does more than is required by public duty owed by law can the promisee sue for the amount promised because only then does the promisee have “something to offer”.

— *Case example* —

During a miners’ strike in South Wales in 1921 the colliery manager applied for police protection and insisted that the police authorities provide a live-in billeted stationary garrison. The police superintendent, who thought that a mobile force would be sufficient, finally agreed to the manager’s request provided the colliery pay £2,200 for provisioning the force and for its service at the rates specified. After order was restored the colliery refused to pay and, when sued by the police, argued that its promise to pay was not supported by any consideration as the police were merely doing what they were legally bound to do. This argument was rejected, and judgment given for the police. Recognising that the police were bound to give protection, the court felt that the form of protection should be at the discretion of the police and that the provision of more than the police superintendent felt necessary in the circumstances provided sufficient consideration to support the colliery manager’s promise to pay the agreed £2,200 to the police.

— *Glasbrook Bros Ltd v Glamorgan County Council*²⁰ —

19. *Collins v Godefroy* (1831) 1 B & Ad 950; 109 ER 1040. See also the relevant Rules of Court.

20. [1925] AC 270; [1924] All ER Rep 579.

¶5-470 Insufficiency of consideration: duty already imposed by contract. A promise to perform a duty already imposed by contract cannot constitute a good consideration.

— *Case examples* —

Two seamen deserted, and the captain, being unable to find substitutes, promised to divide the wages of the deserters amongst the remaining nine members of the crew if they completed the voyage. The court held that the captain's promise was not enforceable because it was not supported by consideration. The crew were already contractually obliged to sail and to cover any emergency. Accordingly one sailor's claim against the captain for the extra wages failed. In the words of Chief Justice *Ellenborough* (at pp 319-320; p 1169):

"Here, I say, the agreement is void for want of consideration. There was no consideration for the ulterior pay promised to the mariners who remained with the ship. Before they sailed from London they had undertaken to do all they could under the emergencies of the voyage. They had sold all their services till the voyage should be completed. If they [the seamen] had been at liberty to quit the vessel at Cronstadt, the case would have been quite different; or if the captain had capriciously discharged the two men who were wanting, the others might not have been compellable to take the whole duty upon themselves, and their agreeing to do so might have been a sufficient consideration for the promise of an advance of wages. But the desertion of a part of the crew is to be considered an emergency of the voyage as much as their death; and those who remain are bound by the terms of their original contract ..."

— *Stilk v Myrick*²¹ —

D, a building contractor, had subcontracted carpentry work on X's project to carpenter P. P later fell into financial difficulty because it turned out that P had under-quoted. Although P had received 80% of the contract price, P had far more than 20% of the subcontract to complete. Because D was at risk due to a penalty clause for late completion in its own contract with X, D offered P an additional payment (about 50% of the original contract) to complete the subcontract as agreed. P made further progress on its subcontract (but was still far from completion) and was paid a further small sum by D. When D failed to pay more of the subcontract price, P stopped work and claimed the balance owing under the original contract and the additional payment. D's defence that the additional promise was unsupported by consideration of P (as P was already under contract to D) and was therefore unenforceable — under the principle in *Stilk v Myrick* — was rejected by the English Court of Appeal. The court approved *Stilk v Myrick* as a cornerstone of the law of contract, but introduced a less rigid approach to consideration. D's additional promise was not forced by P by economic duress — if it had been, it might have been voidable (¶5-720). Instead, it was found to result in benefits to P and D: (1) it kept P in funds and ensured that P continued work under the subcontract without the need for further finance; (2) it enabled D to avoid a penalty in X's contract with D, and (3) it saved D the expense of hiring others to finish the subcontract work. These

21. (1809) 2 Camp 317; 170 ER 1168.

mutual advantages to P and D were held to amount to sufficient consideration to support D's second agreement to pay the additional amount to P.

The argument that D was estopped under the law of promissory estoppel (§15-485) from raising the defence that its promise of the additional payment was not binding was not raised.

_____ *Williams v Roffey Bros & Nicholls (Contractors) Ltd*²² _____

Whether this departure from a rigid approach to consideration will be followed in Australia awaits case law.

If the initial contractual duty is exceeded by something extra being offered, this may constitute good consideration under the old contract or form consideration for a new contract.

_____ *Case example* _____

Seventeen crew members deserted in Port Phillip in 1852 and in order to induce the remaining nineteen members of the crew (of whom only five were able bodied seamen) to complete the voyage to Liverpool via Bombay, the captain promised each crew member an additional £40. Without its full complement the ship was found to be unseaworthy and accordingly all seamen were discharged from their original contracts (of £3 per month for three years). It was held that the agreement to sail an unseaworthy ship could make up good consideration. The undertaking to continue the voyage with the reduced crew was held to be consideration for the captain's promise.

_____ *Hartley v Ponsonby*²³ _____

¶15-480 The rule in *Pinnel's case*. Where the contractual obligation involves the repayment of money, the position of the debtor has been affected by the rule in *Pinnel's case* (see below). This rule means that if D owes P \$10 and if P agrees to accept \$5 from D in full satisfaction, P can later sue D for the unpaid \$5.

_____ *Case examples* _____

P sued D for £8-10-0. D's defence was that he had, at the request of P, tendered £5-2-2 before the debt was due, which P had accepted in full satisfaction for the debt. The rule in *Pinnel's case* is that "payment of a lesser sum on the day²⁴ in satisfaction of a greater, cannot be any satisfaction for the whole, because it appears to the Judges that by no possibility, a lesser sum can be a satisfaction to the plaintiff for a greater sum: but the gift of a horse, hawk, or robe, etc in satisfaction is good ... [as] more beneficial to the plaintiff than the money". D has not offered P consideration for enforcing

22. [1991] 1 QB 1; [1990] 1 All ER 512, noted eg [1990] NZLJ 380; Hooley, R, *Consideration and the existing duty* [1991] JBL 19: the decision is "as incompatible with *Stilk v Myrick* as with the rule in *Pinnel's case*" (§15-480); applied, eg, *Musumeci v Winadell Pty Ltd* (1994) 34 NSWLR 723.

23. (1857) 7 E & B 872; 119 ER 1471.

24. "[I]t would of course be the same after the day" was added in brackets at this point in the quotation in *Foakes v Beer* (below) by Lord Selborne LC at p 612.

P's previous promise not to sue, because all D has done is a part of what D was already obliged to do.

*Pinnel's case*²⁵

P had obtained judgment against D for a debt and costs. D agreed to settle the debt by paying £500 down and £150 per half-year until the total was paid; P agreed not to take further action on the judgment. D eventually paid the amount of the debt and costs and P then sought to recover interest on the judgment debt of £360 which had accrued by statute. It was held that P could so recover because the payment of the smaller sum (ie debt and costs) was not consideration for the promise to take no further action on the judgment.

*Foakes v Beer*²⁶

The rigours and the practical effect of these decisions have been reduced by the following propositions:

- Where the creditor agrees to accept a smaller sum together with something different in kind, the debt is discharged.
- Payment of a smaller amount before the debt is due gives the debtor a legally enforceable discharge, provided it is at the creditor's request.
- Payment of a smaller sum at a different place or in different currency can operate as a legally enforceable discharge if at the request of the creditor.
- Any other act which the debtor is not bound by the contract to perform may result in a legally enforceable discharge.
- A promise by a creditor not to sue the debtor is not supported by consideration, but a promise to abandon a claim (forbearance to sue) is sufficient consideration because the claim may transpire to be good (§5-440).
- The defence of promissory estoppel can be raised (§5-485).
- The defence of fraud on a third party can be raised (§5-490).
- A deed of release can release a debtor.

§5-485 Promissory estoppel. Estoppel is a legal doctrine which prevents a party from asserting in legal proceedings a position contrary to that which has been established by some means (see also §16-380). Promissory estoppel prevents a person from going back upon a promise not to enforce strict (contractual) rights where the promisee has acted in reliance on that promise in such a way as to suffer some detriment were the promisor permitted to renege.

25. (1602) 5 Co Rep 117a; 77 ER 237. In this case D's defence was unsuccessful due to insufficient pleading. Had it not been for that, the judges confirmed that D would have been successful, as payment was made at an earlier date.

26. (1884) 9 App Cas 605; [1881-85] All ER Rep 106. Not a good accord and satisfaction: §6-310.

The principle in *Foakes v Beer* (¶5-480) is intolerable, and it was only a matter of time before the courts found ways to circumvent its rigours. Because the decision provided a basis for striking down quite fair and reasonable transactions on the basis that because they were not supported by consideration they were not contracts, the “innocent” party (the promisee) would apparently have no recourse if the promisor could not be kept to the bargain. Methods of circumventing the decision were noted at ¶5-480, but it is the principle known as “promissory estoppel” (also, “equitable estoppel”, “quasi-estoppel”, or the “new estoppel”) which has been applied by the courts most often to prevent a person from going back on their word by asserting existing legal rights, when the person has made a promise regarding present or future conduct, intended to be binding and intended to be acted upon. Originally known as the *High Trees* principle, promissory estoppel was developed by Denning J (as he then was) in 1946:

— Case examples —

In 1937 P let a block of flats in London to D for 99 years at £2,500 pa. When war broke out it became difficult to fill all the flats and P agreed to reduce the rent to £1,250 for the duration of the war. When the war finished, the rent reverted to the full amount but P claimed the full rent for the whole period. Denning J held that the action failed even though D had not given consideration for P’s promise of not demanding his full rent entitlement. In the words of Denning J:

“There has been a series of decisions over the last fifty years which, although they are said to be cases of estoppel are not really such. They are cases in which a promise was made which was intended to create legal relations and which, to the knowledge of the person making the promise was going to be acted on by the person to whom it was made, and which was in fact so acted on. In such cases the courts have said that the promise must be honoured. ... they are not cases of estoppel in the strict sense. They are really promises — promises intended to be binding, intended to be acted on, and in fact acted on. ... In each case the court held the promise to be binding on the party making it, even though under the old common law it might be difficult to find any consideration for it. The courts have not gone so far as to give a cause of action in damages for the breach of such a promise, but they have refused to allow the party making it to act inconsistently with it. It is in that sense, and that sense only, that such a promise gives rise to an estoppel. ... In my opinion, the time has now come for the validity of such a promise to be recognized. The logical consequence, no doubt is that a promise to accept a smaller sum in discharge of a larger sum, if acted upon, is binding notwithstanding the absence of consideration: and if the fusion of law and equity leads to this result, so much the better. That aspect was not considered in *Foakes v. Beer*. ...”

*Central London Property Trust Ltd v
High Trees House Ltd*²⁷ —

27. [1947] 1 KB 130 at pp 134-135. This principle of equitable estoppel was “reinvented” by Lord Denning by selective use of almost obsolete authority

and was criticised by the black letter lawyers of the day: see Lord Denning (1999) 73 ALJ 159 at p 160.

Purchaser P's solicitor requested from the solicitor for the vendor (D) a seven-day extension of time for settlement of a conveyancing transaction. In reply, the secretary of the solicitor for the vendor (D) said "I think that'll be all right but I'll have to get instructions". By a majority of 3:2, the court held in the circumstances that this statement did *not* amount to an agreement or representation that the vendor would extend the time for settlement and that D was not estopped from asserting that the contract was at an end at the expiry of the settlement date. The tests set out later in more detail in the *Waltons case* (below) were not fulfilled — in particular, the statement was not sufficiently clear and unambiguous to form the basis for a promissory estoppel. The statement did not contain any representation that the purchaser could disregard the settlement date. Neither the solicitor nor the secretary had any actual authority to make any representation to P that D's rights would not be enforced, and D had the right to treat the contract as rescinded if P did not pay on time.

However, the High Court did lay the foundations for the application of the doctrine of promissory estoppel in Australia in the appropriate circumstances.

The court actually did decide in favour of P on the doctrine of "forfeiture" — that a defaulting purchaser is entitled to relief against forfeiture of the purchase price if the purchaser loses the right to specific performance.

*Legione v Hateley*²⁸ —

Had an agreement been entered between P (the promisee — a property owner and developer) and D (the promisor — retailer Waltons Stores) under which P would build and D would lease on a 6 + 6 year lease P's proposed 14,000 sq ft building at Nowra, NSW for a Waltons department store? Negotiations during September–November 1983 provided the basis for the agreement:

21 October: D's solicitor forwarded to P's solicitor a draft Deed of Agreement for Lease with draft lease annexed. When the terms were agreed, exchange of contracts was intended to follow.

1–4 November: Conversations between solicitors with amendments to the lease. D's solicitor specified 15 January 1984 as the date by which the premises were to be ready for fitting out by D.

7 November: P's solicitor specified that the agreement must be concluded in the next day or two so that P could complete construction by the date specified by D. D's solicitor communicated D's verbal approval of P's amendments, and forwarded amended documents with the proviso that specific approval had not yet been received but that P's solicitor would be informed the next day if any of the amendments had not been agreed to. A Schedule of Finishes was yet to be annexed. There were no further communications on the amendments.

11 November: P's solicitor forwarded the signed amended deed "by way of exchange", with the Schedule of Finishes. P then went ahead and with the knowledge of D arranged finance, ordered building materials, and commenced demolition of the old building and construction of the new one for D.

21 November: D's enthusiasm for the project waned after a review of its

28. (1983) 152 CLR 406; (1983) 57 ALJR 292.

country retailing strategy, and having received advice from its solicitor that as contracts had not been exchanged by both parties it was not bound to proceed with this arrangement, D instructed its solicitors to "go slow" until D made a final decision.

18 January 1984: D instructed its solicitors to communicate to P its final decision, namely, that it was not proceeding with the project. By this time, and as known by D, the building was approximately 40% complete.

In response P commenced legal proceedings for a declaration that there was a valid and enforceable agreement for the taking of the lease, and an order for specific performance of that agreement.

The High Court, after observing that the contract had not been completed and that, technically, D was not legally bound by it, held (per the whole Court) that an equitable estoppel operated to bind D, the effect of the estoppel being that D could not deny the existence of a contract which was legally binding. It was found that the facts of the case showed that P assumed that amendments were acceptable to D so that the exchange of contracts was only a formality. The High Court affirmed that the doctrine of promissory estoppel extends to representations or promises regarding future conduct, but noted that to date the doctrine has been mainly confined to precluding departure from a representation by persons in a pre-existing contractual relationship that they will not enforce their contractual rights whether they be pre-existing or rights to be acquired as a result of the representation. In the present case, P had acted on a non-contractual promise on which it had relied, to its detriment. The judgment of *Brennan J* sets out the scope of the doctrine of promissory estoppel in Australian law and its application to the facts of the *Walton's case*:

"In my opinion, to establish an equitable estoppel, it is necessary for a plaintiff to prove that (1) the plaintiff assumed or expected that a particular legal relationship exists between the plaintiff and the defendant or that a particular legal relationship will exist between them and, in the latter case, that the defendant is not free to withdraw from the expected legal relationship; (2) the defendant has induced the plaintiff to adopt that assumption or expectation; (3) the plaintiff acts or abstains from acting in reliance on the assumption or expectation; (4) the defendant knew or intended him to do so; (5) the plaintiff's action or inaction will occasion detriment if the assumption or expectation is not fulfilled; and (6) the defendant has failed to act to avoid that detriment whether by fulfilling the assumption or expectation or otherwise ..."

Because D (by its solicitor) knew that P (by its solicitor) had said P would commence work only if the agreement was concluded, D must have known that P assumed that the contract had been made or expected that it would be made and that D was not free to withdraw. D intended that P should continue to build the store in reliance on that assumption or expectation. At that time D had to elect either to terminate the negotiations or allow P to continue. D's silence induced P to continue either on the assumption that D was already bound or in the expectation that D would execute and deliver the original deed as a matter of obligation. Having elected to allow P to continue to build, it was too late for D to reclaim the initial freedom to withdraw. As P would suffer loss if D failed to execute and deliver the original deed, an equity was raised in favour of P. That equity was to be satisfied by treating D as though it had done what it had induced P to expect

it would do. Thus, promissory estoppel operated in favour of P to treat D as though it had executed and delivered the original deed.

*Waltons Stores (Interstate) Ltd v Maher*²⁹

P (aged 64) agreed with D (his 88-year-old widowed mother) to migrate from England (where he was living with his family in a rent-free Council house) to Australia with his family and to live with and to care for her, in return for which she undertook to buy a house in Australia and to put it in his name. Instead she put it in her own name, and seven days after P and his family moved in she evicted them from the new extended family home in Brisbane. In legal proceedings against D, a number of legal issues were raised:

- (1) *Statute of Frauds*: ¶5-030. Because it was not in writing, the contract was found to be unenforceable. Nor were there sufficient acts of part performance to permit enforcement of the contract in equity to avoid the consequences of non-compliance with the *Statute of Frauds*.
- (2) Intention to create legal relations. It was held that the agreement was not simply a family arrangement (¶5-110).
- (3) Promissory estoppel. Finding for P, the court held that an interest in land (ie the house) may arise by promissory estoppel "where a party has acted to his detriment in consequence of an expectation created ... by another that the interest in the land will be granted". The fact that P's detriment was not directly related to the land, nor that D did not own the land when encouraging the expectation, did not affect the creation of this interest in the land.

*Riches v Hogben*³⁰

The operation of promissory or equitable estoppel was summarised by the New South Wales Court of Appeal in the following words:³¹

"For equitable estoppel to operate there must be the creation or encouragement by the defendant in the plaintiff of an assumption that a contract will come into existence or a promise be performed or an interest granted to the plaintiff by the defendant, and reliance on that by the plaintiff, in circumstances where departure from the assumption by the defendant would be unconscionable."

The promisee's position must have been altered in reliance on the promise. If so, promissory estoppel operates as a cause of action (as a sword) and no longer merely as a defence (as a shield). However, if no real detriment or material prejudice or no alteration of position as a result of the conduct of the promisor could be shown by the promisee there would be no evidence of promissory estoppel to bind the promisor.

29. (1988) 164 CLR 387; (1988) 62 ALJR 110; noted, eg (1988) 62 ALJ 568; (1988) 104 LQR 362. See further Prindable, PM, *Is offer and acceptance no longer consideration? An examination of the implications of the Waltons v Maher concept of promissory estoppel* (1996) 16 Qld Lawyer 169.

30. [1986] 1 Qd R 315.

31. In the words of Priestley JA in *Austotel Pty Ltd v Franklins Selfserve Pty Ltd*, (1989) 16 NSWLR 582 at p 610 refining his earlier words in *Silovi Pty Ltd v Barbaro* (1988) 13 NSWLR 466 at p 472.

Since the *Waltons Stores* case, promissory estoppel has been raised in the following situations:

— *Case examples* —

The deceased farmer had promised to marry the plaintiff following his divorce and the couple agreed to pool assets on marriage. Each worked on the other's farm without payment. When the relationship did not end in marriage, the court held that these facts did not give rise to the application of the principles of promissory estoppel and did not justify the imposition of a constructive trust (¶9-755).

— *Public Trustee v Kukula*³² —

HMAS *Melbourne* and HMAS *Voyager* collided in February 1964. In 1984, the plaintiff sailor sued for damages for personal injuries alleging negligence. Before and after the claim the Commonwealth stated that its policy was not to contest liability, but in 1985 it raised as defences the statute of limitations and absence of a duty of care (¶4-080). The High Court held that the Commonwealth was estopped from going back on its promise not to raise the statute of limitations. In the words of *Deane J*:

"The central principle of the doctrine is that the law will not permit an unconscionable — or, more accurately, unconscientious — departure by one party from the subject matter of an assumption which has been adopted by the other party as the basis of some relationship, course of conduct, act or omission which would operate to that other party's detriment if the assumption be not adhered to for the purposes of the litigation."

— *Commonwealth of Australia v Verwayen*³³ —

When Mr and Mrs P (P) advertised No 16 (the house) and No 16A (the depot and workshop) for sale, Mr and Mrs D (D) claimed beneficial ownership. P unsuccessfully claimed possession, and D claimed specific performance.

No 16. D moved into the house owned by P (Mr P was Mr D's uncle) at No 16 in 1968, paying instalments on P's mortgage and then "rent", and expected that they would be able to purchase the property at less than market value. The court held that although there was no legally enforceable agreement to sell No 16 — there was no agreed price, no agreement on how to fix a price and no agreement on dates — P was estopped from denying the assumption of D that they would be able to buy the property: D had fulfilled test (5) (detriment) of *Waltons v Maher* (above) because they had been deprived of the chance to purchase the house at less than market value and of being credited with the instalments they had paid. The court ordered the sale of No 16, with the proceeds to be divided equally.

No 16A. In 1981, P sold their cartage business to D, and D paid \$2,000 for No 16A. There was an enforceable agreement to sell No 16A, and specific performance was ordered against P.

— *Blazely v Whiley*³⁴ —

32. (1990) 14 Fam LR 97.

33. (1990) 170 CLR 394 at p 444; (1990) 64 ALJR 540 at p 560, by a majority of four to three. Of the majority, only *Deane* and *Dawson JJ* applied promissory

estoppel. *Toohy* and *Gaudron JJ* held that the Commonwealth had waived its rights under the statute of limitation.

34. (1995) 5 Tas R 254.

The directors of a company objected to the bank's appointment of a receiver over the company but believed they had no choice. However, the bank failed to make out that the directors by their silence were estopped from challenging the appointment. The bank had acted as it thought it was entitled to do, and there was no evidence to indicate that it had acted under an incorrect assumption that the directors did not object: "the case is entirely lacking an element of unconscionability so evidently required by ... *Verwayen*."

_____ *Pan Foods Company Importers and Distributors Pty Ltd v Australia and New Zealand Banking Group Ltd*³⁵ _____

The parties to a contract will be bound by the dates of the contract unless there is evidence that they intend to extend the dates. If there is such evidence, estoppel would compel the party creating the assumption to adhere to it.

_____ *Government Employees Superannuation Board v Martin*³⁶ _____

The promised lot. P left school at 15 to work on his parents' farm, first as an employee and from the age of 17 as a partner in the family business. P worked without wages but received pocket money and expenses. P was successful in suing his parents on the basis of promissory estoppel for not honouring a promise to subdivide the farm to create a separate lot for him. The court confirmed that promissory estoppel is based on "an equity which bound [the promisor] to make good the [promisee's] expectation". Because P incurred substantial detriment by continuing to contribute his labour and the use of his share of the partnership funds to improve the farm, the parents were ordered to compensate P by making good the expectation which they had created.

_____ *Giumelli v Giumelli*³⁷ _____

P, who had been dismissed from employment, agreed in writing that he would accept the outcome of and would be bound by the findings of an arbitration (¶1-441) on the dismissal and that he would "not seek to pursue this matter in any other tribunal or court." Dissatisfied with the result of the arbitration and in breach of this agreement, P appealed to the Federal Court. P's appeal was dismissed on the basis of the equitable estoppel against P. The court held that it would be unconscionable to allow P to depart from the assumption that he had created or encouraged — that he would be bound by the arbitration. On the basis of this assumption, P's former employer had agreed to the arbitration and to the payment of six weeks' pay in lieu of notice.

_____ *Horsman v Commissioner of Main Roads*³⁸ _____

¶5-490 Insufficiency of consideration: part payment from third party. A creditor who has agreed to accept less than the full debt in full settlement is permitted under the rule in *Pinnel's case* to sue for the balance (¶5-480). Promissory estoppel provides one exception to this rule

35. (1996) 14 ACLC 698 at p 714.

36. (1997) 19 WAR 224.

37. (1999) 196 CLR 101; (1999) 73 ALJR 38. [1999] FCA 1733.

547 at p 554, noted (1999) 73 ALJ 491; ¶9-755.

(¶5-485). The law also considers that such action on the part of the creditor, if it induces other creditors to refrain from seeking recovery of their debts and induces the debtor not to pay them, is a fraud against those creditors (the third parties) since, as a result, the creditor receives a preference (¶13-690—¶13-700). Where a third party offers to pay a smaller sum than the debt in satisfaction of it, and the creditor accepts, the acceptance of the sum operates as a full discharge for the debtor. Strictly the debtor is in no position to offer any consideration for the creditor's undertaking not to insist on the debt. It has been held that if the creditor sued the debtor, the action would be in effect a fraud on the third party, who was induced to pay the smaller sum on the faith that its acceptance would provide a discharge of the debtor's liability to the creditor.³⁹

— *Case example* —

The debtor's father wrote to the creditor and offered a lesser sum "in full settlement" of the debt, and enclosed a draft for the lesser sum. The creditor cashed the draft and later brought an action against the debtor to recover the balance of the debt. The court rejected the action on the basis that the creditor must be taken to have accepted the amount received by him on the terms on which it was offered, and therefore the creditor could not maintain the action.

— *Hirachand Punamchand v Temple*⁴⁰ —

¶5-495 Insufficiency of consideration: composition with creditors. At common law, an arrangement of all a debtor's creditors to accept a particular percentage of their debts in full satisfaction did not provide sufficient consideration under the rule in *Pinnel's case* (¶5-480). However, there are at least three ways of validating a composition with creditors.

- (1) if the creditors agree to do *something more* — such as agreeing not to enforce their individual claims — the arrangement with the debtor is binding in contract;⁴¹
- (2) the promises of the creditors could also be enforceable as joint promises under the rule in *Coull's case* (¶6-260), and
- (3) an arrangement can be made with creditors under the *Bankruptcy Act 1966* (Cth), discussed at ¶13-570.

¶5-497 Insufficiency of consideration: moral obligation. Moral obligation, and "natural love and affection", are not sufficient consideration to convert a promise into a contract.⁴² One of the members of the former Taxation Board of Review (now Administrative Appeals Tribunal) put it in these words:⁴³

39. *Welby v Drake* (1825) 1 C & P 557; 171 ER 1315.

40. [1911] 2 KB 330.

41. *Good v Cheesman* (1831) 2 B & Ad 328 at p 333; 109 ER 1165 at p 1167.

42. eg *Sturlyn v Albany* (1587) Cro Eliz 67; 78 ER 327. See also *Eastwood v Kenyon* (1840) 11 Ad & E 438 at p 450; 113 ER 482 at p 486.

43. (1968) 17 TBRD Case S2 at p 11.

“... the only consideration referred to in the purported assignment [ie contract] is the assignor’s ‘love and affection for the Assignee’. However warm those sentiments may be over the matrimonial hearth, they have long since been chilled to complete sterility in the corridors of the courts and they now provide no comfort to those who would rely upon them as consideration.”

— *Case example* —

Sarah, the infant daughter of John Sutcliffe, was left as sole heiress when Sutcliffe died. Sarah’s guardian (P) incurred expenses in her maintenance and education and for the benefit of her estate, and when she came of age she promised to reimburse him. Sarah later married D who, in gratitude for what P had done over the years for his new wife, also promised to reimburse him. P was later unsuccessful in legal action to hold D to his promise, on the grounds that there was no consideration to support D’s promise to pay. Moral obligation to pay was not recognised, since if it were, such “doctrine would annihilate the necessity for any consideration at all.”

— *Eastwood v Kenyon*⁴⁴ —

¶5-498 Insufficiency of consideration: illusory or uncertain promises. A contract made for a consideration which is illusory is unenforceable. Illusory or uncertain terms breach contract principles that “acceptance must be clear and certain” (¶5-260) and the requirement of certainty of contract (¶6-150).

¶5-500 Consideration must move from the promisee. As a contract involves two parties, the promisor and the promisee, the promise of the promisor will remain unsupported by consideration and therefore legally ineffective unless supported by consideration of the person to whom the promise is addressed, the promisee. This means that if A promises to pay B \$100 if C will fix A’s car, B cannot enforce A’s promise because B has offered no consideration for A’s promise. B could only enforce that promise if he, B, had undertaken to organise C to fix the car (or if C was an employee of B), in which case B will have provided consideration for A’s promise.⁴⁵

On the other hand, where A promises B to pay \$100 per week to C as an allowance, C has no rights to enforce the arrangement between A and B because C acquires no rights against A (under the doctrine of privity — ¶6-260—¶6-270) because the A/B contract has nothing really to do with C.

This outcome does not reflect the intention of the parties A and B. It has been criticised and its modification was suggested in 1937 by the English Law Revision Committee which recommended that “where a contract by its express terms purports to confer a benefit on a third party, the third party shall be entitled to enforce the provision in his own name”. Lord Denning attempted to achieve this result in *Beswick v Beswick* (see ¶6-260) without success.

44. (1840) 11 Ad & E 438 at p 450; 113 ER 482 at p 486.

45. Under the rule in *Tweddle v Atkinson* (1861) 1 B & S 393; 121 ER 762.

Consideration provided by somebody else, not a party to the contract, does not move from the promisee.

LEGAL CAPACITY

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¶5-510 Importance of capacity. A contract may not be valid if one or both parties lack the legal capacity to contract. Although there is the presumption of full capacity, care should be taken in dealings with certain persons because of the invalidating effects of the lack of capacity to contract. At least six classes of person are (or, in the case of married women, were) subject to degrees of incapacity to enter enforceable contracts:

- | | |
|--------------------------------|-------------------------------------|
| (1) minors (¶5-520 — ¶5-535); | (4) married women (¶5-560); |
| (2) the mentally ill (¶5-540); | (5) corporations (¶5-570); |
| (3) the intoxicated (¶5-550); | (6) “capital felons”. ⁴⁶ |

¶5-520 Minors' contracts. Legislation provides for full contractual capacity at the age of 18 years.¹ The legislation is matched by other legislation which gives to 18-year-olds the right to vote, buy liquor, become a company director, marry, divorce, and make a will.²

The law of minors' contracts — made up of the common law and legislation in some jurisdictions — has two main aims:

- (1) to protect those under 18 (called “minors”; under the earlier law those under 21 were called “infants”) from entering disadvantageous contracts because of their lack of understanding or their inexperience; and

46. Prisoners have full capacity to sue and be sued and to enter into contracts: eg *Felons (Civil Proceedings) Act 1981* (NSW); *Prisoners (Removal of Civil Disabilities) Act 1991* (Tas).

1. *Age of Majority Act 1977* (Vic); *Minors (Property and Contracts) Act 1970* (NSW); *Law Reform Act 1995* (Qld) sec 17 (What is age of majority); *Age of Majority (Reduction) Act 1971* (SA); *Age of Majority Act 1972* (WA); *Age of Majority Act 1973* (Tas); *Age of Majority Act 1974* (ACT); *Age of Majority Act 1974* (NT). This or related legislation in all

jurisdictions except South Australia abolishes the common law rule that a person attains an age expressed in years at the first moment of the day before the person's birthday: *Family Law* (1990) 64 ALJ 429, 720.

2. In contrast, a child with maturity and understanding can leave home before the age of 18 because the parent's right of control of a child is a “dwindling right” which yields to the child's right to make decisions: *At what age can a child leave home?* (1988) 62 ALJ 548.

- (2) to ensure that the law does not unnecessarily prejudice adults who deal with minors, because if it did, adults would not deal with minors and minors would be unable to obtain goods and services.

Apart from the exceptions outlined below, contracts are not enforceable *against* minors, but minors can enforce their contracts *against* the other party, as this law seeks to protect minors from their inexperience and not the parties with whom they contract. The protection given by the law is one-sided but limitations have been developed to prohibit minors from profiting at the expense of those dealing with them fairly:

- (1) Minor's liability in tort. So long as the action is not a means of indirect enforcement of an unenforceable contract, a minor can be sued for torts such as:
 - trespass (intentional injury). A friend of a minor (the hirer, an undergraduate aged 19) who had hired a mare jumped it contrary to the owner's instructions. The mare was injured and died. As jumping was not contemplated by the contract, the minor (the hirer) was sued for trespass.³
 - detainee (specific return of goods). If the contract does not permit parting with possession of goods bailed (¶15-110), a minor who has parted with possession could be sued for detainee.⁴
 - negligence. A person injured by a minor's negligent action could sue the minor in tort.
 - deceit (to recover damages for fraud), such as fraudulent representation of full age.
- (2) Minor's liability in equity. Although lack of legal capacity can be used as a defence to action in contract, equity law (¶1-010) through the equitable doctrine of restitution (¶6-510) may require a minor to return ill-gotten gains so long as the action is separate from the contract. Restitution is authorised by minors' contracts legislation in two jurisdictions.⁵ In equity even if the minor has disposed of the property, the rightful owner may be able to claim it back in limited circumstances from third parties under the equitable doctrine of tracing (the right to follow assets) so long as the action is not enforcing a void contract indirectly.

The law does not allow an unenforceable minor's contract to be enforced indirectly, so action in tort or equity must be for conduct by the minor which is outside and independent of the unenforceable contract.

Minors' contracts can be classified as *valid*, *voidable* and *void*:

Valid minors' contracts. At common law the only contracts binding on minors are of two classes:

3. *Burnard v Haggis* (1863) 14 CBNS 45; 143 ER 360.

4. *Ballett v Mingay* [1943] KB 281 (hire of radio).

5. *Minors (Property and Contracts) Act 1970* (NSW) sec 37 (¶5-530); *Minors Contracts (Miscellaneous Provisions) Act 1979* (SA) sec 7 (¶5-535).

(a) Contracts for “necessaries”. Such contracts are for those goods and services reasonably necessary not to minors in general but to the particular minor’s “station in life” and to the minor’s actual requirements, such as food, clothing, accommodation,⁶ and medical services and education.

The Sale of Goods Acts⁷ provide that capacity to buy and sell is regulated by the general law concerning capacity to contract and to transfer and acquire property, and that where necessities (ie goods suitable to the condition in life of the purchaser and to the purchaser’s actual requirements at the time of sale and delivery) are sold and delivered to a minor, or to a person who by reason of mental incapacity (¶5-540) or drunkenness (¶5-550) is incompetent to contract, the purchaser must pay a reasonable price for them.

“Necessaries” have been held *not* to include luxuries such as fancy waistcoats; curios, including over 20 snuff boxes, candlesticks, and weapons; a racehorse and a vanity case; and also have been held not to include a trading contract⁸ and a contract for the building of a house.⁹

(b) Employment, apprenticeship and training contracts. These contracts are the second exception to the rule of non-enforceability of minors’ contracts: a minor *is* bound by a contract of employment, apprenticeship, training or education:

- if for the minor’s benefit, and
- whether or not for necessities.

For example, a contract by actor Charles Chaplin’s son Michael, when aged 19, to publish his (Michael’s) memoirs,¹⁰ and a contract to secure a passport, were held to be beneficial to the minor in question and therefore enforceable against him:

— *Case example* —

Les Darcy (1895-1917) was a professional boxer, who, as his career developed, wanted to go to the USA to gain further instruction which was unavailable in Australia. P, with Darcy’s consent, went to Melbourne to arrange for a passport. In the meantime Darcy absconded to the USA, in circumstances still hotly debated, without a passport. It was understood by Darcy that he would have to pay for P’s application whether successful or not. Darcy pleaded infancy to an action by P for his remuneration. The verdict for P

6. Because of minors’ contracts laws, some landlords are reluctant to rent residential accommodation to young people and students because the lease may be unenforceable by the landlord. The Queensland Law Reform Commission has recommended change to this area of minors’ contracts law to confirm the minor’s capacity to contract: QLRC, *Minors’ Civil Law Capacity*, Report No 50, 1996.

7. NSW sec 7; Vic sec 7; Qld sec 5; SA sec 2; WA sec 2; Tas sec 7; ACT sec 7; NT sec 7.

8. *Whundo Copper Syndicate v Ferrari* [1962] WAR 24.

9. *Sultman v Bond* [1956] St R Qd 180.

10. *Chaplin v Leslie Frewin (Publishers) Ltd* [1966] Ch 71.

was affirmed on appeal. The jury was justified in finding that services rendered by P were necessities.

— *McLaughlin v Darcy*¹¹ —

Voidable minors' contracts: contracts binding unless repudiated by the minor.

Some contracts where one party is a minor are binding on both parties unless and until the minor repudiates them while under 18 or within a reasonable time after turning 18. They are voidable at the instance of the minor. These are contracts which involve acquiring "an interest in property of a permanent nature" or contracts with a "continuing obligation". Examples include contracts involving land, leases, partnerships, marriage settlements and contracts for shares in a company. If, however, the minor has had some benefit under the contract, the refund which may be owing upon repudiation may be reduced to reflect the benefit received.

— ***Case example*** —

Miss Tulip Steinberg, a minor, applied for and was allotted 500 shares in the defendant company. She paid both the amount due on the allotment and the first call on the shares. Eighteen months later while still a minor, she purported to repudiate the contract and attempted to recover the money she had paid. Because she had received the 500 shares she had applied for, she was not able to recover her money as there had not been a total failure of consideration.

— *Steinberg v Scala (Leeds) Ltd*¹² —

If the minor has received no benefit under the contract, the full amount paid should be recoverable by the minor upon repudiation. Property which has passed to a minor under a voidable minors' contract cannot be recovered by the adult from the minor whether the minor has provided full, part or no consideration.

Void minors' contracts: contracts not binding unless ratified. Minors' contracts which are not valid or voidable as set out above do not bind the minor, but do bind the other party. They do not have to be repudiated by the minor. They are only binding if ratified by the minor at or within a reasonable time after the age of majority.

Legislation in some jurisdictions provides that a promise made after majority to pay a debt contracted during minority, or any ratification or confirmation of a minor's contract, will be effective if evidenced in writing.¹³

Minors can be sued on cheques, bills of exchange or promissory notes, as for valid minors' contracts, and their signature is effective to draw, issue or indorse: if dishonoured, the holder would have to sue parties other than the minor.¹⁴

11. (1918) 18 SR (NSW) 585.

12. [1923] 2 Ch 452; [1923] All ER Rep 239.

13. eg *Statute of Frauds (Amendment) Act 1828* (Imp) 9 Geo IV c 14 sec 5 (which

applies in WA and the NT as part of the inherited common law); *Mercantile Law Act 1962* (ACT) sec 15.

14. *Cheques Act 1986* (Cth) sec 30; *Bills of Exchange Act 1909* (Cth) sec 27, 95.

Legislation in New South Wales, South Australia and Tasmania confirms that a contract made by a person acting as a guarantor of a minor's contract is enforceable against the guarantor — even if the minor's contract is void (¶13-370).¹⁵

Complex problems can be created by minors' contract law, and contract law does not really treat a minor's promises seriously despite their potentially serious impact on business. In response, the Western Australian Law Reform Commission recommended that any contract with a minor should be enforceable both by and against the minor, subject to ordinary contract principles.¹⁶

Indeed, one of the aims of minor's contract law — to protect minors from their inexperience — is now weakened by two modern legal developments:

- the rise of consumer protection legislation (especially in the *Trade Practices Act 1974* (Cth) and State/Territory Fair Trading Acts, discussed in Chapter 7) and
- unconscionability laws (¶15-730ff).

In addition, the possible reluctance of adults to contract with minors may be affected by minors' rights under anti-discrimination legislation, which prohibits direct and indirect discrimination on the basis of age.¹⁷

¶5-525 Minors' contracts in Victoria. Minors' contracts in Victoria are governed by the three classes of contract set out in the common law, with modifications made by "infants relief" legislation passed in the late nineteenth century to:

- (1) render void certain classes of minors' contracts: (a) contracts for the repayment of money lent or to be lent, (b) contracts for the payment of goods supplied or to be supplied (other than necessities) and (c) accounts stated for non-necessaries (sec 49);
- (2) provide that no legal proceedings can be brought against a person who ratifies a minor's contract at the age of majority (sec 50);
- (3) avoid a contract made after reaching majority to repay a loan entered as a minor (sec 51).¹⁸

15. *Minors (Property and Contracts) Act 1970* (NSW) sec 47; *Minors Contracts (Miscellaneous Provisions) Act 1979* (SA) sec 5, as recommended for Qld by the QLRC, *Minors' Civil Law Capacity*, Draft Report No WP 45; *Minors Contracts Act 1988* (Tas) sec 4; ¶5-535. Sec 55(3) of the Consumer Credit Code requires a notice that the guarantor may not be entitled to indemnity against a minor debtor.

16. In a report not acted upon: Western Australian Law Reform Commission,

Report on Minors' Contracts, Perth, 1988, noted [1988] Reform 186.

17. eg *Anti-Discrimination Act 1977* (NSW) Part 4G; 1991 (Qld) sec 7(1)(f); 1992 (NT) sec 19(1)(d).

18. *Supreme Court Act 1986* (Vic), based in part on the now-repealed *Infants Relief Act 1874* (Imp). See also Davis, JLR, *Continuation in Victoria of anachronistic English statutory provisions* (1987) 61 ALJ 265.

— *Case example* —

P Bank gave father, mother and their 15-year old son (D3) an industrial property loan secured by a mortgage over their land and the two factories which they built on it. When payments on the mortgage fell into arrears, the court held that although the registered mortgage (¶13-040) was “void as against” D3 under sec 49(a), it would not be deleted from the Torrens register (¶13-300). Hence D3 had no defence to the bank’s claim under the mortgage which resulted in judgment for possession and an order for sale.

*Horvath v Commonwealth Bank of Australia*¹⁹ —

¶5-530 Minors’ contracts in New South Wales. The *Minors (Property and Contracts) Act 1970* (NSW) lowered the age of majority in New South Wales from 21 to 18, and governs the contractual capacity of minors under the age of 18.²⁰ The Act provides in sec 8 that persons have full contractual capacity in relation to “civil acts” once they turn 18 years of age. However, the combined effect of sec 17, 18 and 19 is that where a minor participates in a civil act it is not generally binding on the minor, but it is presumptively binding where that participation is for the benefit of the minor at the time of participation. In this context a civil act is “any act relating to contractual or proprietary rights or obligations or to any chose in action”: see sec 6(1) which enumerates specific examples of civil acts including a contract.

The test is whether the civil act is for the “benefit” of the minor and whether the minor understands the nature of it (sec 18, 19). Although the term “benefit” is not defined, it is wider than the concept of necessities. If the tests are satisfied, then the minor is “presumptively bound”. In deciding if the contract is beneficial it must be considered as a whole, and the question of fact answered in view of the minor’s age, station in life, and current supply of the goods and services contracted for, and whether the contract is advantageous to the minor. If the contract is found to be “presumptively binding” then the minor is bound to the agreement as if not under the disability of minority (sec 6(3)), and it can only be attacked on grounds such as fraud or duress.

— *Case example* —

Shares in a company subject to a takeover were transferred to minors by a deed of agreement signed by each minor’s guardian to be “warehoused” to prevent compulsory acquisition of the shares by the takeover bidder. The share transfers were held to be ineffective because the minors had not signed them (sec 16) and they were not of “benefit” to them as required by sec 19

19. (1999) V ConvR ¶54-595 (Court of Appeal). If the mortgage had been found void, the court would have upheld the bank’s claim that it was subrogated to the right to the equitable lien of an unpaid vendor and therefore that the property

was charged with the repayment of the loan: ¶13-280; ¶13-290.

20. See Harland, DJ, *The Law of Minors in Relation to Contracts and Property*, Butterworths, 1974; Pearce, DC, *Reform of the law of infancy* (1970) 44 ALJ 269.

of the New South Wales Act. Therefore the minors' names could not be entered on the target company's register of members.

———— *Homestake Gold of Australia Ltd v Peninsula Gold Pty Ltd*²¹ ————

Under sec 30 a minor may affirm civil acts after turning 18, and a civil act may be affirmed by the courts before the minor turns 18 either on the minor's application or on the application of the other party to the act. If a civil act is not repudiated by a minor either during minority or before turning 19, then it becomes presumptively binding under sec 31. But civil acts for the benefit of minors may not be repudiated.

The courts are given wide powers (in sec 37) to adjust the rights between the parties in relation to all civil acts by minors, including powers over repudiation by minors, and restitution of goods and benefits to their original suppliers.

¶5-535 Minors' contracts in South Australia. The law governing minors in South Australia is the common law as amended by the *Minors Contracts (Miscellaneous Provisions) Act 1979* (SA). This Act leaves the general approach of the law untouched (ie contracts are unenforceable against infants, with exceptions in favour of contracts for necessities and beneficial contracts of service), although it gives legislative effect to certain specific recommendations made by the Law Reform Committee of South Australia:

- (1) A contract that is unenforceable by reason of minority remains unenforceable unless ratified in writing (sec 4). There is no specified time within which a particular contract which is the subject of sec 4 must be ratified by a minor.
- (2) The minority of a principal contracting party does not of itself protect an adult guarantor (sec 5).²²
- (3) A contract with a minor can have effect as if the minor had, before entering into the contract, attained majority if, before the contract was entered into, its terms were approved by a court (sec 6).
- (4) A discretion is given to the court to enable it to order restitution of some or all of the property provided by the minor when a contract is properly avoided (sec 7). Prior to the enactment of this provision the position was that where a minor avoided a contract, the minor could not recover money paid or property transferred pursuant to the contract unless there had been a total failure of consideration.
- (5) The court has power, upon application by a minor or a parent or a

21. (1996) 14 ACLC 903.

22. In New South Wales and Tasmania an adult guarantor of the contract of a minor is also bound: *Minors (Property and Contracts) Act 1970* (NSW) sec 47; *Minors*

Contracts Act 1988 (Tas) sec 4. At common law, a guarantor of a minor's contract is not liable if the principal contract is void: eg *Land and Homes (WA) Ltd v Roe* (1936) 39 WALR 27.

guardian of a minor, to appoint a person to transact any specified business, or business of a specified class, or to execute any documents on behalf of the minor (sec 8).

¶5-540 The mentally ill. As genuine consent and meeting of minds is the basis of contract, a person suffering from a mental disorder is unable to enter a valid contract. But as this general rule would allow people to avoid their contractual obligations by feigning mental incapacity, it has been interpreted as meaning that the mentally ill are bound by their contracts unless:

- they can show they did not understand what they were doing at the time of contracting, and
- the other person was aware of their impaired mental condition.

The burden of proving these two matters lies on the mentally disordered person. If they can be proved, the contract is voidable at the option of the mentally disordered person.²³ If they cannot be proved, such as where person A suffering mental illness enters a contract during a lucid period with person B, who is unaware of any mental disability on the part of A, the contract will not be able to be set aside by person A or A's representative.²⁴

(On insanity as grounds for dissolution of partnership see ¶10-530.)

¶5-550 The intoxicated. Incapacity through alcohol or other drugs is judged by the same test of incapacity as for the mentally ill (¶5-540). If the same two matters can be proved, such a contract is voidable at the instance of the intoxicated person. On regaining soberness, the intoxicated person may either withdraw from the contract or ratify it.²⁵

However, intoxication which does not prevent understanding of the transaction and which only lubricates one's business faculties is generally no ground for avoidance of contractual relations unless the judgment of the party in question was really affected.²⁶

¶5-560 Married women. Until the late nineteenth century, married women lacked full legal capacity on the technicality that on marriage their legal personality and their legal estate merged with that of their husband. Statutory change to this incapacity began in the UK in 1857 and legislation in force in all States now gives a married woman full contractual capacity.²⁷

23. *Imperial Loan Co v Stone* [1892] 1 QB 599.

24. *Hart v O'Connor* [1985] AC 1000.

25. *Matthews v Baxter* (1873) LR 8 Ex 132.

26. *Blomley v Ryan* (1956) 99 CLR 362.

27. *Marriage Act 1958* (Vic) Pt 8; *Law of Property Act 1936* (SA) sec 92; *Married*

Women's Property Act 1935 (Tas); *Married Persons (Equality of Status) Act 1996* (NSW); *Property Law Act 1974* (Qld) sec 15; *Law Reform Act 1995* (Qld) sec 18; *Married Women's Property Act 1892* (WA); *Married Persons' Property Act 1986* (ACT); *Married Persons (Equality of Status) Act 1989* (NT); noted *Family Law* (1991) 65 ALJ 98.

The presumption that where spouses are living together the wife is able to pledge the husband's credit for necessities suitable to their style of living applies where a man lives with a woman to whom he is not married and allows her to pass as his wife, even if the supplier of the necessities is aware that they are not married. The presumption is raised by the fact of cohabitation: ¶11-080.

¶5-570 Corporations: contractual capacity. A company is a legal "person" in the same way as a "natural" person is a "person".²⁸ A company, which is an artificially created legal person, must be distinguished from individuals who are shareholders in it: "it must be treated like any other independent person with its rights and liabilities appropriate to itself".²⁹

The contractual capacity of a corporation is limited in two ways:

(1) *by natural impossibility.* By virtue of its nature as an artificial rather than a natural person, a corporation itself cannot sign contracts and forms and speak on the phone. All these are done by an agent on its behalf. Personal contracts (like getting married, or advising as solicitor or accountant) cannot be carried on by a corporation³⁰ (contrast architect, engineer), as the personal element is lacking.

Modern company practice is to confer on the directors the right to exercise the company's powers, except those that by statute must be exercised in the general meeting. This wide delegation of the company's powers is to directors acting as a board, not to the directors individually. It is the function of the board to lay down the policy or general rules to be followed in the conduct of the company's business. It is for management to make the day to day decisions consistent with the board's policy. The company management and secretariat are directly under the board, being appointed by it and directly responsible to it. Officers of the company who are members of management are empowered, by virtue of their office and the authority delegated to them by the board, to bind the company in contract, and their actions constitute company actions.

(2) *by legal impossibility.* Before 1 January 1984 companies were limited in their objects and powers because of the doctrine of *ultra vires*: actions beyond their expressly defined objects and powers could have no effect if the company was not "programmed" to so act. The abolition of the doctrine of *ultra vires* (at least as it affects persons dealing with companies) is discussed at ¶9-490.

28. eg *Acts Interpretation Act 1901* (Cth) sec 22. See ¶2-220; ¶9-270.

29. *Salomon v Salomon & Co Ltd* [1897] AC 22, per *Halsbury* LC.

30. Sec 84 of the *Trade Practices Act 1974* (Cth) extends the common law of principal and agent by providing that

where it is necessary to establish the state of mind of a corporation, the "state of mind" of a director, servant (ie employee) or agent acting within the scope of that person's actual or apparent authority is the state of mind of the corporation: ¶8-760.

Section 126(1) of the Corporations Law explains the form company contracts are to take, namely, the same form as required in contracts of individuals: hence, contracts which individuals would have to make by deed may be made in writing by a company under its seal (§5-040). Contracts which individuals are required to make in writing (§5-030) may be made on behalf of the company in writing by a person authorised by the company. Contracts which may be made orally by individuals may be made on behalf of a company by a person authorised by it; and this authority may be express or implied.

GENUINE CONSENT

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¶5-610 The requirement of consent. Consent is the fifth requirement for a valid contract. Unless there is consent, there can be no agreement and no contract between the parties. Even if consent is given, it may not have been freely given (fraud or misrepresentation), or it may have been gained by mistake, or under pressure (duress, undue influence). In the

area of unconscionability, a court can strike down a contract on the basis of more general unfairness between the parties. If consent is gained by misrepresentation, the misrepresentation may be found to be misleading or deceptive conduct in breach of sec 52 of the *Trade Practices Act 1974* (Cth) (if applicable: ¶5-010).

¶5-620 Mistake. Even with the best of intentions, mistakes do happen. In contract law, remedies for mistake (¶5-691) are restricted, narrow and technical, with contract law saying that there is no general right to be released from a contract on the basis of mistake regarding the subject matter of the contract or even the identity of the other contracting party. In recent years, cases which might otherwise have been litigated on the basis of mistake at common law have been brought under the *Trade Practices Act* for “misleading or deceptive conduct” under sec 52, “unconscionable conduct” under sec 51AA-51AC (and unconscionable conduct at common law) or as “false or misleading representations” under sec 53: ¶5-691.

An error of judgment gives no right of release from a contract. If B buys an article thinking it is worth \$100 when it is really only worth \$50, B generally has no right to withdraw from the contract and get a refund. The law says that a valid contract once made cannot be unmade unless there was misrepresentation or fraud by the seller. If B agrees to buy a roadhouse on a main highway which A knows is about to be re-routed, B cannot withdraw from the contract on the grounds of mistake unless B has been misled by A. In that case B may have the right to have the contract rescinded for misrepresentation, or sue under the *Trade Practices Act* and/or in tort for damages for deceit.

The courts are reluctant to set aside a contract merely because one or both parties later discovers facts which they contend would have dissuaded them from entering the contract had they known of them.

- Because mistake avoids the contract *ab initio* (from the beginning) the rights of innocent third parties could be adversely affected (¶5-685). If B buys A's car in good faith, and if the contract between A and B were declared void, C would not acquire ownership (under the *nemo dat* rule: ¶3-270) and would have to return the car to the true owner A. C may have rights against B under sale of goods legislation, for example where B has represented to C that B has the right to sell the goods (¶7-035ff), but these may not be of much value if B has disappeared.
- If the sanctity and reliability of contracts could be easily set aside on the grounds of mistake on the part of disappointed parties, the law would encourage false and fraudulent claims of mistake.

Mistake is traditionally classified into three types:

- (1) Common mistake, where each party makes the same mistake and each party is mistaken about a basic fact of the contract such as the continued existence of the subject matter (¶5-640—¶5-650).
- (2) Mutual mistake, where the parties are at cross-purposes, such as A

agreeing to sell her car (her Nissan) and B agreeing to buy A's car (meaning A's Toyota) (§5-660).

- (3) Unilateral mistake, where only one of the parties is mistaken, such as B agreeing to buy an oil painting from A, believing it to be a Streeton original while to A's knowledge it is in fact a very good copy (§5-670).

Mistake may also be classified by reference to its effect at common law or in equity. The following paragraphs illustrate the principle that the common law may avoid a contract for mistake of fact or law and treat it as void. Some of the following cases also illustrate the application of remedies at common law, in equity and under legislation (§5-691).

§5-640 Common mistake: subject matter non-existent.

Where performance of a contract becomes impossible because the subject matter has been destroyed or has ceased to exist, without the fault of either party (*res extincta*), the parties are mutually excused from performance of the contract. Such mistake about the existence of the subject matter prevents any contract relating to it from being formed, and in these circumstances the law will generally set the contract aside from the beginning. The contract is said to be void *ab initio*.

Examples of common mistake include:

- Sale of cargo which has, unknown to either party, sunk at sea.
- A life insurance policy taken out on the life of someone who is, unknown to the parties, already dead. In one case, a life policy had lapsed because premiums had not been paid. Without either the beneficiary or the insurer knowing it, the life assured had already died when the beneficiary paid overdue premiums to renew the policy. In an action to recover the amount paid, it was held that the contract was void *ab initio* because of the common mistake on the existence of the subject matter and therefore the amounts were recoverable by the beneficiary.³¹
- A contract to sell goods which, unknown to the parties, are non-existent at the time of the making of the contract.

— Case example —

A cargo of corn on board ship in the Mediterranean was the subject of a contract between a purchaser (Callender) and a seller (Hastie). Because tempestuous weather delayed the voyage and caused the corn to ferment, the ship's master sold it at Tunis (unknown to the parties) before the voyage was completed. In other words, when the contract of sale was made, the corn was no longer in existence. On learning of this, the purchaser repudiated the contract. Action was taken by the seller (Hastie) against his agent (Couturier) under their *del credere* agency (ie an agency agreement where

31. *Pritchard v Merchant's and Tradesman's Mutual Life Assurance Society* (1858) 3 CBNS 622; 140 ER 885.

the agent undertakes to indemnify the principal for any losses arising from repudiation of the contract: ¶11-030). The court held that the seller's claim failed because the contract contemplated that there existed something to be bought, sold and capable of transfer. As the corn had already been sold, the purchaser was not liable. There was no contract.

*Couturier v Hastie*³² —

In other words, where an essential element does not exist, a condition precedent of the contract is not fulfilled. No action for breach of contract could then be possible.

Sale of goods legislation has incorporated this principle of common mistake by putting the common law position into the following statutory form:³³

“Where there is a contract for the sale of specific goods, and the goods without the knowledge of the seller have perished at the time when the contract is made the contract is void.”

— *Case example* —

A contract was entered between P (the plaintiff) and D (the defendant) for the sale of 4,000 Canonbar sheep. P inspected some as to quality but did not count the numbers available, because they were scattered over a wide area and mingled with others. A number perished through drought and cold, and at the time of delivery only about 1,000 could be found. P claimed that D, the vendor, was in breach of contract by not delivering the full amount; but the claim failed on the basis that the contract could only apply to the sheep in existence at the date of the contract.

*Goldsbrough Mort & Co Ltd v Carter*³⁴ —

If the sheep had been penned and counted at the time of the contract, *res extincta* could not be advanced. Nor could it be advanced if D had purposely exaggerated the number hoping to find sufficient to fulfil the terms of the contract. Mistake as grounds of cancellation of a contract must really be handled with care, especially in view of *McRae's case* where the court was not prepared to unwrite the contract in facts very like those above:

— *Case example* —

The Commonwealth Disposals Commission invited tenders “for the purchase of an oil tanker lying on Jourmaund Reef, which is approximately 100 miles north of Samarai. The vessel is said to contain oil”. The plaintiff *McRae's* offer of £285 was accepted. *McRae* fitted out a salvage expedition but the tanker could not be found although in the sale note it was described as “approximately 100 miles north of Samarai”. *McRae's* action for recovery

32. (1856) 5 HLCas 673; 10 ER 1065. See also Atiyah, PS, *Couturier v Hastie and the sale of non-existent goods* (1957) 73 LQR 340.

33. *Sale of Goods Act 1923* (NSW) sec 11; *Goods Act 1958* (Vic) sec 11; *Sale of*

Goods Act 1896 (Qld) sec 9; 1895 (SA) sec 6; 1895 (WA) sec 6; 1896 (Tas) sec 11; *Sale of Goods Act 1954* (ACT) sec 11; *Sale of Goods Act 1972* (NT) sec 11.

34. (1914) 19 CLR 429.

of damages for breach of contract was met with an attempt by the Commission to avoid the contract for mistake. This was rejected by the High Court, and damages of £3,285 were awarded including the expense incurred in equipping the expedition.

— *McRae v Commonwealth Disposals Commission*³⁵ —

The *res extincta* cases were said to be inapplicable in this case. The assumption that the tanker was where it was described to be could not be said to have been intended by both parties to be a condition precedent (¶16-060) because, although the Commission had made such an assumption, the plaintiff had not. The plaintiff had no more information than was given by the Commission's officers and to that extent the court held that the contract included a promise by the Commission that there was a tanker in the position specified. The Commission had contracted that there was a ship where described; there was not and the Commission was held liable for breach of contract. Mistake could not be relied upon because any mistake was self-induced by the Commission's assertion that there was a ship at a defined place. Several times the court said that the Commission's officers were "reckless" and "irresponsible" to insert an advertisement with such a description. In other words, if the case were to be regarded as containing an element of mistake, the Commonwealth could not rely on the mistake because it had been induced by its own people to assert the existence of the oil tanker.

¶15-650 Common mistake: nothing to sell. Where people make contracts to acquire property which they later find they already own, such contracts are void. A contract entered into on the assumption that a person is alive who is not in fact alive is also void.

— *Case examples* —

Cochrane was the trustee in bankruptcy of Joseph Willis, the life tenant of a certain estate. Daniel Willis and Henry Willis (those entitled to the estate after the death of Joseph) contracted with Cochrane to refrain from cutting the timber on the estate and from selling it for the benefit of Joseph's creditors. It later transpired that when this agreement was made, Joseph had died and the estate had therefore legally passed to Daniel. Action by Cochrane to enforce the contract failed on the basis that it was void for common mistake because, in the circumstances, Daniel had made a contract to preserve property which was already his: "it would be contrary to all the rules of equity and common law to give effect to such an agreement".

— *Cochrane v Willis*³⁶ —

A contract for the sale of a life policy was entered into in the belief that the assured was alive and the contract was completed by assignment. The assured was dead at the date on which the contract was made and the contract for assignment was therefore held to be void for mistake and was able to be set aside.

— *Scott v Coulson*³⁷ —

35. (1951) 84 CLR 377.

36. (1865) 1 Ch App 58 at p 63.

37. [1903] 2 Ch 249.

¶15-660 Mutual mistake. The essence of mutual mistake is that the parties are at cross-purposes. The parties have made a mistake on a fundamental fact concerning the contract but each party has made a different mistake; eg A has agreed to sell her car (her Nissan) and B has agreed to buy A's car (meaning A's Toyota). Offer and acceptance have not corresponded and in these circumstances no actual agreement in respect of the common object has been made. In other words, with no meeting of the minds and the parties at cross-purposes, each party has made its own mistake.

— *Case example* —

D agreed to buy "125 bales of Surat cotton ... to arrive ex Peerless from Bombay". There were two ships of that name, one sailing in October and the other in December. P's offer was with respect to the Peerless sailing in December, whereas D's acceptance was for the October sailing. It was held that there could be no binding contract because P and D each intended to contract with respect to different ships; therefore the contract was void *ab initio* because the minds of the parties had never met and on an objective view there was no evidence of any clear and definite agreement.

*Raffles v Wichelhaus*³⁸ —

In determining the existence of mutual mistake, the courts apply an objective test to the conduct of the parties.

— *Case example* —

A contracted to sell oats to B. When A tendered new oats, B refused to accept them on the basis that B had old oats in mind. As the contract did not specify old or new oats, it was held that A's tender of new oats was good and therefore B was liable on the contract.

This case raises two important points, expressed by the court as follows:

(1) Rejection of mistake on these facts:

"an argument ... was pressed upon us, that the defendant in the present case intended to buy old oats, and the plaintiff to sell new, so that the two minds were not *ad idem*; and that consequently there was no contract. This argument proceeds on the fallacy of confounding what was merely a motive operating on the buyer to induce him to buy with one of the essential conditions of the contract. ... All that can be said is, that the two minds were not *ad idem* as to the age of the oats; they certainly were *ad idem* as to the sale and purchase of them."

(2) The objective test to determine the existence of mutual mistake:

"If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms."

*Smith v Hughes*³⁹ —

38. (1864) 2 H & C 906; 159 ER 375.

39. (1871) LR 6 QB 597 at pp 606, 607.

Relief in equity. If a contract is void at common law, it will also be void in equity (§1-010). Even if a contract is valid and enforceable at common law, an equitable remedy such as specific performance (§6-400) may be available to prevent injustice to the defendant.

— *Case example* —

The Ship Inn. D purchased the Ship Inn with all its outbuildings and land at auction in the mistaken belief that the property included two areas of garden at the rear of the inn. These areas originally belonged to vendor P, but had been sold earlier and were used by P under lease from the present owner. The plan of the property was displayed at the auction and the property was adequately described in the contract. On realising the mistake, D refused to complete the sale. P was entitled to specific performance to order D to complete. D had made a mistake but that mistake was of his own making: "If a man will not take reasonable care to ascertain what he is buying he must take the consequences." Even though P and D were not fully agreed on the property, D had raised an implication by his conduct that he was prepared to buy the property as offered.

— *Tamplin v James*⁴⁰ —

Although presented by the purchaser as a case of mistake in defence to the vendor's action for specific performance (§6-400), it would be difficult to categorise this case as an example of either mutual mistake or unilateral mistake, as the vendor of the land was under no misapprehension as to the contents of the sale and would not have had an accurate assessment of the purchaser's belief. The objective test of *Baggallay* LJ holds the key to resolving most such cases:⁴¹

"[A] court of equity will refuse specific performance of an agreement when the defendant has entered into it under a mistake, and where injustice would be done to him were performance to be enforced ... But where there has been no misrepresentation, and where there is no ambiguity in the terms of the contract, the defendant cannot be allowed to evade the performance of it by the simple statement that he has made a mistake. Were such to be the law the performance of a contract could rarely be enforced upon an unwilling party who was also unscrupulous."

— *Case example* —

P purchased an option to buy land (§3-250) held by D under leasehold title from the Crown which was stated to be 30 shillings per acre "calculated on a freehold basis". The contract did not mention which party would have to bear the costs of converting the leasehold to freehold. D testified that when he gave the option he had in mind that he would receive 30 shillings net per acre and that he would not be liable to bear the costs of conversion of the Crown land to freehold. The High Court took the view that the expression "calculated on a freehold basis" was not ambiguous and on an objective analysis (and in the absence of fraud, misleading or hardship in the bargain)

40. (1880) 15 Ch D 215.

41. Ibid at pp 217-218.

it meant that 30 shillings per acre was the total sum to be paid by P and that D would have to bear the costs of converting the land to freehold.

— *Goldsbrough Mort & Co Ltd v Quinn*⁴² —

However, a different conclusion in regard to mistake was reached in the following case:

— *Case example* —

D was a Chinese landlord who could neither read nor write English and who could only speak it imperfectly. P wished to lease a shop from D and the two parties negotiated in person, thus giving P a chance to observe D's command of English. P prepared a lease which he and a third person believed they had explained to D before D signed it, but D believed it was only a letter of introduction to his (D's) agent. P believed D understood its effect, and when D sought to avoid the contract, having learned its true effect, P unsuccessfully sought to have the contract enforced. The court held that in view of the circumstances P took the risk that D might successfully raise the defence that he did, namely that he did not intend to enter into anything in the nature of a contract. Where D conducts himself in such a manner that P could assume that D would intend to be legally bound, there would be a binding contract; otherwise, there would be no binding contract.

— *Lee v Ah Gee*⁴³ —

Bearing in mind the “proviso” in *Quinn's case*, namely, that because of the absence of fraud or misleading conduct there was no mistake, the decision in *Lee's case* can be held to be consistent and to fall into place. The facts in *Lee* represent an extreme case indicating that P took advantage of D and knew at the time that he was taking advantage of D's almost total lack of understanding of the English language. In addition, when the facts make it clear, by application of the objective test, that no real agreement can be logically imputed between the parties, the court will set aside the “attempted” contract.

¶5-665 Common mistake as to character or value. Consistent with the reluctance of the courts to interfere with the sanctity of contract on the grounds of mistake, it is especially clear that a common mistake about the character or value of the subject matter of the contract will not avoid the contract where there is evidence that the parties are in agreement on that subject matter. A has agreed to buy B's Arthur Streeton painting for \$100,000 and all the necessary contractual factors such as offer and acceptance and consideration are present. The painting turns out to be a very good quality reproduction — a fact of which neither party was aware — yet such mistake has no legal effect unless there was fraud or misrepresentation.

— *Case examples* —

The manager of a subsidiary of Lever Bros was paid £30,000 compensation for early termination of his employment. Subsequently it was discovered that the company could have sacked him anyway for breaches as a director.

42. (1910) 10 CLR 674.

43. [1920] VLR 278.

Could the company recover the amount paid? No, on the basis that the contract to pay was not void for common mistake. There was a contract and it was enforceable. The effect of this mistake was set out as follows:

"Mistake as to quality of the thing contracted for raises more difficult questions. In such a case a mistake will not affect assent unless it is the mistake of both parties, and is as to the existence of some quality which makes the thing without the quality essentially different from the thing as it was believed to be. ... it would be wrong to decide that an agreement to terminate a definite specified contract is void if it turns out that the agreement had already been broken and could have been terminated otherwise. The contract released is the identical contract in both cases, and the party paying for release gets exactly what he bargains for. It seems immaterial that he could have got the same result in another way, or if he had known the true facts he would not have entered into the bargain. A buys B's horse; he thinks the horse is sound and he pays the price of a sound horse; he would certainly not have bought the horse if he had known as the fact is that the horse is unsound. If B has made no representation as to soundness and has not contracted that the horse is sound, A is bound and cannot recover the price ... Does the state of the new facts destroy the identity of the subject-matter as it was in the original state of facts?"

— *Bell v Lever Brothers Ltd*⁴⁴ —

In 1944 P purchased from the D gallery for £85 a painting of Salisbury Cathedral which both P and D honestly believed to be by the English landscape painter John Constable. When P attempted to resell the painting five years later it was discovered that the painting was not by Constable, and P sued to recover the amount he had paid. The court rejected his claim, holding that even though it could be said that the mistake was "in one sense essential or fundamental", it was not sufficient to avoid the contract.

— *Leaf v International Galleries*⁴⁵ —

In 1986 P purchased from D, an art gallery selling on consignment for a vendor, two paintings for a total of \$7,000 and two for a total of \$6,250. Both P and D honestly believed the paintings to be originals by modern Australian painters Ian Fairweather and Lloyd Rees respectively. All four paintings proved to be forgeries, and P unsuccessfully sued the D gallery to recover the amount he had paid subject to re-delivery of the paintings. The action was brought not under breach of contract or contract law mistake, but under the *Trade Practices Act 1974* (Cth) sec 52 (misleading or deceptive conduct: ¶7-250ff). The statements of authenticity made by D were held not to be misleading or deceptive, as D, without personal expertise and knowledge of the paintings, was only conveying information given by the vendor. Although D did not disclaim belief in the truth or falseness of what the vendor had told him and was only passing it on for what it was worth (*Yorke v Lucas*: ¶7-250), that did not in itself make his statements misleading within sec 52.

— *The Saints Gallery Pty Ltd v Plummer*⁴⁶ —

44. [1932] AC 161, per Lord *Atkin* at pp 218, 223-224, 227; Smith, JC, *Contracts — mistake, frustration and implied terms* (1994) 110 LQR 400 at p 419: "*Bell v Lever Bros* is arguably wrongly decided".

45. [1950] 2 KB 86; [1950] 1 All ER 693.

46. (1988) ATPR ¶40-882; (1988) 80 ALR 525; noted (1988) 62 ALJ 796.

P leased a flat from D at a rental of £250 per annum. Both P and D believed that structural improvements made to the flat by D rendered it a "new and separate dwelling" and therefore no longer subject to rent control. It was later discovered that this was not so. The flat was still subject to rent control with a maximum rent of £140 per annum, and although an increase in rent was justified by the improvements, D should have given P notice of the increase. Nevertheless, it was held that the contract was not void *ab initio*, and that P could not claim the overpaid rent from D. *Denning LJ* stated the law, as laid down in *Bell v Lever Brothers Ltd*,⁴⁷ to be as follows:

"... once a contract has been made, that is to say, once the parties, whatever their inmost states of mind, have to all outward appearances agreed with sufficient certainty in the same terms on the same subject-matter, then the contract is good unless and until it is set aside for breach of some condition expressed or implied in it, or for fraud, or on some equitable ground. Neither party can rely on his own mistake to say it was a nullity from the beginning, no matter that it was a mistake which to his mind was fundamental, and no matter that the other party knew he was under a mistake."

However, although the court refused to rule that this lease was void, it did exercise its equitable jurisdiction to set the contract aside:

"The court had power to set aside the contract whenever it was of opinion that it was unconscionable for the other party to avail himself of the legal advantage which he had obtained ... if the parties were under a common misapprehension either as to facts or as to their relative and respective rights, provided that the misapprehension was fundamental and that the party seeking to set it aside was not himself at fault."

— *Solle v Butcher*⁴⁸ —

Despite these words of Lord *Denning*, the High Court has pointed out that even though a mistake may be to some extent fundamental, it may not operate so as to avoid the contract.

Hence, in *Svanosio v McNamara*,⁴⁹ where both parties were honestly mistaken as to the true and exact location of the subject matter of the contract (a hotel at Bendigo), the High Court declined to interfere, stating that contracts should not be set aside for mistake in the absence of fraud or other misrepresentation.

On the other hand, in *Lukacs v Wood*,⁵⁰ where through a conveyancing error an allotment of land on which a block of flats was erected was transferred instead of a vacant allotment of land, an order was made directing the purchaser to reconvey the land to the vendor in exchange for a transfer of the vacant land which was intended to be sold. In this case, unlike *Svanosio v McNamara*, there was a "wholly inadequate" consideration.

47. [1930] AC 161; [1931] All ER Rep 1.

49. (1956) 96 CLR 186.

48. [1950] 1 KB 671 at pp 691, 692-693;
[1949] 2 All ER 1107 at pp 1119-1120.

50. (1978) 19 SASR 520.

¶5-670 Unilateral mistake. The situation where A agrees to buy an oil painting from B which A believes to be a genuine Tom Roberts but which is in fact, to B's knowledge, a copy, leads to complications. This type of mistake is called unilateral because only one party is mistaken. In these circumstances there can be no contract because A's offer and B's acceptance do not correspond. As the parties are never in agreement there is no contract between them.

— *Case examples* —

D offered to sell P 30,000 Argentine hare skins but by mistake misquoted the price as being so much per pound instead of so much per piece. The misquotation would result in D receiving one-third of the amount expected, yet the previous negotiations had proceeded on the basis that the price was to be per piece according to ordinary trade usage (¶6-120). P purported to accept the offer, taking advantage of D's mistake, but action to enforce the contract failed on the basis that P, and anyone else with any knowledge of the trade, must have realised that there was a mistake.

The court was prepared to accept the proposition that P must have known that D's offer did not express D's true intention. If, on the other hand, P had had no experience in the fur trade, or in how prices were quoted, or if the previous negotiations had referred to prices only and not pieces or pounds, the result could not have been the same. In other words, if P had not known that D was mistaken, all the contractual ingredients would have been present and once made, a good contract cannot be unmade.

— *Hartog v Colin and Shields*¹ —

Mrs Johnson (P) granted an option (¶3-250; ¶5-365) to Mr Taylor (D) to purchase 10 acres of land near Windsor, New South Wales for \$15,000. When the option was exercised, P claimed she believed the documents specified \$15,000 per acre or \$150,000 in all, and sought either rectification (¶5-695) or rescission for unilateral mistake. The High Court upheld P's claim for rescission because D was aware that circumstances existed which indicated P was contracting under mistake or misapprehension. D had not materially altered his position and no third party rights had intervened:

"[A] party who has entered into a written contract under a serious mistake about its contents in relation to a fundamental term will be entitled in equity to an order rescinding the contract if the other party is aware that circumstances exist which indicate that the first party is entering the contract under some serious mistake or misapprehension about either the content or subject matter of that term and deliberately sets out to ensure that the first party does not become aware of the existence of his mistake or misapprehension. ... it is unfair that the mistaken party should be held to the written contract by the other party whose lack of precise knowledge of the first party's actual mistake proceeds from wilful ignorance because, knowing or having reason

1. [1939] 3 All ER 566.

to know that there is some mistake or misapprehension, he engages deliberately in a course of conduct which is designed to inhibit discovery of it.”

_____ *Taylor v Johnson*² _____

P purchased farming land from D sight unseen which proved not to be as represented — it was unfenced, uncleared and had no dams. D offered other land as a “swap”, and P mistakenly signed what he believed to be the “swap” documentation. In fact, the documentation included a mortgage and loan for an increased amount for the swap. Quoting the passage cited above from *Taylor v Johnson*, this transaction was declared void *ab initio* for mistake.

_____ *Lee v Cafred Pty Ltd*³ _____

Investors voluntarily signing mortgages could not later raise mistake to have them declared void and unenforceable.

_____ *Keith Murphy Pty Ltd v Custom Credit Corporation Ltd*⁴ _____

¶5-675 Unilateral mistake: mistaken identity. Unilateral mistake has led to contracts being declared void where X has contracted with Y on the basis that Y is another person Z and where Y knows of X’s misapprehension. If it can be proved that this was so and that Y was aware of the mistake at the time of accepting X’s offer, there is no correspondence of offer or acceptance and therefore no contract.

There is a presumption that, despite the mistake, a contract was concluded between the parties, in light of the fact that the offer was accepted by the person to whom it was addressed. The onus of rebutting the presumption lies upon the party pleading the mistake of identity, ie the offeror. In order to succeed the offeror must show:

- (1) that at the time of making the offer the offeror regarded the identity of the offeree as a matter of vital importance;
- (2) that the offeror intended to deal with some person other than the acceptor and took reasonable steps to verify that he was dealing with the other person;
- (3) that the acceptor was aware of the offeror’s intention.

It must be established that the offeror’s mind was specifically and exclusively addressed to an offeree other than the acceptor and that this was known to the acceptor.

— *Case example* —

A highly respectable firm called W Blenkiron & Son carried on business at 123 Wood Street, Cheapside. A fraud called Alfred Blenkarn, renting 37 Wood

2. (1983) 151 CLR 422 at pp 432, 433; noted (1983) 57 ALJ 296; Duggan, A, Bryan, M and Hanks, F, *Contractual Non-Disclosure*, Longman Professional, 1994, Ch 2.

3. (1992) ATPR ¶41-170. D’s conduct was also unconscionable (¶5-730) and in breach of *Trade Practices Act* sec 52 (¶7-280).

4. (1992) 6 WAR 332, ¶10-060.

Street, Cheapside, decided to profit from the similarity. He wrote to Messrs Lindsay & Co, linen manufacturers in Belfast, and ordered a quantity of handkerchiefs. He signed his letters "Blenkiron & Co" of 37 Wood Street. Messrs Lindsay knew of Blenkiron & Son, but not their exact address, and on this basis supplied the goods as ordered. Blenkarn did not pay for the goods and sold them to Cundy, who was sued by Messrs Lindsay & Co for conversion (§14-020) on the basis that the contract made with Blenkarn was void for mistake and that ownership of the goods never passed to Blenkarn. It was held that the mistake related to the actual identity of the other party and that because the other party was not who it was supposed to be, no contract ever came into existence.

— *Cundy v Lindsay*⁵ —

¶5-680 Mistaken identity: contrasting decisions. Contrast this with an alternative situation. If Y contracts with X by leading X to believe that he (Y) is Z, the contract will not be void for mistake if X does not intend to contract specifically with Z. If X has never heard of Y or Z before, he cannot say that he intended to contract specifically with either party.

— *Case example* —

X dispatched goods to Y who had ordered them posing as a member of a non-existent firm called Hallam & Co, Soho Hackle Pin and Wire Works, Sheffield. Y later sold the goods to D who took them in good faith and for value. When Y did not pay for the goods, X unsuccessfully sued D for conversion. It was held that there was no mistake as to identity because X was found to have contracted with the writer of the letter, whatever his name was and so the goods could not be recovered from D.

— *King's Norton Metal Co Ltd v Edridge,
Merrett & Co Ltd*⁶ —

The so-called contrast is compounded by the following two cases.

— *Case examples* —

A rogue entered P's shop and selected several pieces of jewellery. When he was signing a cheque for the amount of £3,000, he said, "You see who I am, I am Sir George Bullough", a person known by reputation to P. P checked a directory and confirmed that Sir George lived at the address given and allowed him to take the jewellery on the faith of the cheque. The rogue pawned the jewellery with the innocent D, and P's action to recover the jewellery failed on the basis that P had intended to contract with the person who had entered the shop, whether he was Sir George Bullough or not. Therefore there was no operative mistake and the property in the jewellery had passed to that person, who was able to give good title to D.

— *Phillips v Brooks Ltd*⁷ —

5. (1878) 3 App Cas 459; [1874-80] All ER Rep 1149.

7. [1919] 2 KB 243; [1918-19] All ER Rep 246.

6. (1897) 14 TLR 98.

A rogue approached the plaintiffs (two sisters) who were selling their car and agreed to buy it for £717. To persuade them to accept a cheque he said that he was PGM Hutchinson, that he lived at Stanstead House, Caterham, and that he had business interests at Guildford. The plaintiffs checked the telephone directory and confirmed these details and allowed him to take the car on the faith of the cheque. The rogue sold the car to the innocent D, and the plaintiffs sought to recover the car from D on the basis that the contract between themselves and the rogue was void for mistake and that property therefore did not pass. Their action to recover the car succeeded on the basis that they had intended to contract only with Hutchinson and that this offer could not be accepted by a person representing himself to be Hutchinson. No contract had been formed and the plaintiffs were entitled to return of the car from D.

*Ingram v Little*⁸ —

There are a number of possible differences between these two cases:

- (1) The contract of sale passing the property to the rogue was concluded before the rogue made the fraudulent misrepresentation in *Phillips' case* whereas in *Ingram v Little* the representation was made before the contract was concluded.
- (2) Mistake as to identity is different from mistake as to attributes such as credit worthiness. Mistake as to identity avoids a contract (*Ingram*) whereas mistake as to attributes does not (*Phillips*).
- (3) The determining factor is the identity of the offeree and whether that is a matter of vital importance. If it is (*Ingram*) and if the identity is incorrect, there is no contract.

¶5-685 Mistaken identity: protection of third parties. In *Lewis v Avery*, Lord Denning dismissed the distinctions mentioned in ¶5-680 because of the injustice worked on innocent third parties who have taken the goods in question after the initial “mistake”. He preferred the view that a contract based on mistaken identity was voidable by the mistaken person, rather than void, provided innocent third parties had not already acquired rights under it.

— *Case example* —

A rogue posing as a well known film actor of that period, Richard Greene of the Robin Hood TV series, convinced L to allow him to drive away a car he had paid for by cheque after purporting to confirm his bogus identity as a film star with an entry card to the Pinewood film studios. The cheque, it transpired, was stolen, and the rogue sold the car to A. An action by L to recover the car failed. The court held that L had contracted with the rogue and had failed to rebut a presumption to the contrary by allowing the car to be driven away.

8. [1961] 1 QB 31; [1960] 3 All ER 332.

The facts were closer to those of *Ingram* because of the necessity of the rogue's alias squaring up with his story; again the rights of two innocent parties (the seller, the third party) were at stake. Lord *Denning* said:

"As I listened to the argument in this case, I felt it wrong that an innocent purchaser (who knew nothing of what passed between the seller and the rogue) should have his title depend on such refinements. After all, he has acted with complete circumspection and in entire good faith: whereas it was the seller who let the rogue have the goods and thus enabled him to commit the fraud. I do not, therefore, accept the theory that a mistake as to identity renders a contract void. I think the true principle is that which underlies the decision of this court in *King's Norton Metal Co Ltd v Edridge, Merrett & Co Ltd*⁽⁹⁾ and of *Horridge J* in *Phillips v Brooks*,⁽¹⁰⁾ which has stood for these last 50 years. It is this: When two parties have come to a contract — or rather what appears, on the face of it, to be a contract — the fact that one party is mistaken as to the identity of the other does not mean that there is no contract, or that the contract is a nullity and void from the beginning. It only means that the contract is voidable, that is, liable to be set aside at the instance of the mistaken person, so long as he does so before third parties have in good faith acquired rights under it."

*Lewis v Averay*¹¹ —

In *Phillips v Brooks* and *Lewis v Averay* it could be argued that the plaintiffs had not tried hard enough to test the truth of the identities of the fraudulent parties and had thus failed to rebut the presumption.

It is difficult to distinguish *Ingram v Little* and justify the decision for the plaintiffs in that case save that in the other cases the plaintiffs had heard of the people they thought they were dealing with.

It is the concern of the judges to protect innocent third parties (and at the same time not undermine the principles and practice of commercial life) that accounts for the presumption that the contract is not void *ab initio* but merely voidable for fraud. It is this that a plaintiff must rebut in cases where mistake as to identity is alleged. The remedy for mistake is that the parties are returned to their pre-contractual position as far as is possible. This is done on the basis of treating a contract as void for mistake, ie there was no agreement in the first place. Although in *Phillips v Brooks* and *Lewis v Averay* the plaintiffs would have succeeded in an action based on fraudulent misrepresentation this, on the facts, could not have assisted them. The remedy for fraudulent misrepresentation is that a contract becomes voidable at the time the defrauded party elects to avoid it, ie the contract will subsist until avoided. Thus innocent third parties who take property have a good title only if they do so before the contract is avoided.

9. (1897) 14 TLR 98.

11. [1972] 1 QB 198 at p 207.

10. [1919] 2 KB 243; [1918-19] All ER Rep 246.

¶5-686 Mistake of law. A person who makes a payment under a mistake of law may be able to recover that payment by restitution (¶6-510). The High Court in the *David Securities* case¹² rejected earlier case law which had prevented recovery of money paid under a mistake of law in circumstances where a person has paid a recipient who was not legally entitled to payment. The court confirmed that the mistake of law must be “causative” — that the mistake was the cause of the payment — but rejected other limitations on its operation such as that the mistake of law must be “fundamental” or that there must be “unjustness” over and above the mistake. “The fact that the payment has been caused by a mistake is sufficient to give rise to a prima facie obligation on the part of the respondent to make restitution”.¹³ This decision now overcomes the need to plead complete failure of consideration, abuse of a fiduciary relationship, mistake of fact or involuntariness.

The person who has received the payment may not have to make restitution (ie to repay) if such repayment would be unjust, such as where:

- (1) the payment was made for good consideration, for example to discharge an existing debt;
- (2) the payment was made voluntarily; or
- (3) the payee received the payment in good faith and altered its position in reliance on the validity of the payment.¹⁴

— *Case example* —

The “Condor”. The builder of a luxury launch refunded to the purchaser \$91,000 paid for sales tax in reliance on the purchaser’s advice that the transaction was sales tax exempt. Following an audit by the Australian Taxation Office, the builder was required to pay the sales tax. It then successfully sued the purchaser for repayment of the refunded sales tax (with interest) on the basis that the refund was made under the builder’s mistake of law.

— *Inn Leisure Industries Pty Ltd (Provisional Liquidator Appointed) v DF McCloy Pty Ltd*¹⁵ —

¶5-690 Mistake as to nature of document: *non est factum*. When a person has signed a document believing it to be something different from what it actually is, that person may be able to rely on the defence of *non est factum* (“it is not my deed”) to have the document declared void for mistake. Fraud or misrepresentation is often the motive giving rise to such deception, and the reported cases include mistakenly signed documents such as bills of exchange, contracts, deeds and property transfers. Without such a defence, the mistaken person may be legally liable under a document appearing to be valid and binding.

12. *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353; ¶6-510; ¶16-060.

14. This is provided for in *Property Law Act 1969* (WA) sec 125(2).

15. (1991) 100 ALR 447.

13. (1992) 175 CLR 353 at p 379.

The basis of the defence of *non est factum* is that in truth the document has not been executed at all. The person signing it is not bound by it, it is void, and an innocent third party does not acquire any rights to any property supposedly transferred by the document.

The defence of *non est factum* is available to persons who are at a disadvantage, such as:

- a person under a temporary disability;
- those who cannot read or understand the document;
- the mentally infirm if they cannot understand the document.

It would be very rare for persons of full age and capacity to be able to claim the defence.

The defence of *non est factum* places a heavy onus on the person claiming the defence, especially in cases where a decision that a document is of no legal effect will affect third parties.

To successfully claim the defence, the mistake must relate to the class of document itself, and not merely to the details of the document. The document must be radically different from what it is in fact, and not just different in degree. Therefore the *non est factum* defence is not made out if:

- a person understands the nature of the document, but is mistaken about its contents or legal effect, or
- it is caused by a person's carelessness or negligence such as not taking reasonable precautions to determine the character of the document.

— *Case examples* —

P, a widow aged 78, signed a document which her nephew's business partner D had told her was a deed of gift of her home to the nephew. It turned out that the document was in fact a deed of assignment (sale) to D, and D subsequently mortgaged the house to a building society as security for finance to pay personal debts. D later defaulted under the mortgage, and the building society wished to enforce its security. P unsuccessfully brought legal action against D and the building society for a declaration that the deed was void on the defence of *non est factum*. P's case failed because there was no radical difference between what P signed and what P thought she was signing — although the transferees were different, both were transfers and there was therefore no "fundamental", "serious" or "very substantial" difference in the documents.

*Saunders (Executrix of the Estate of Rose Maud Gallie, Deceased) v Anglia Building Society*¹⁶ —

P, who spoke little English and could not read English, gave D a six-month option to purchase his property in consideration of \$50. When the option was not exercised within the six months, D forwarded another \$50 and a document which P signed, thinking it was a receipt. The second document

16. [1971] AC 1004, on appeal from *Gallie v Lee* [1969] 1 All ER 1062.

turned out to be an option for a second six-month period, and D later purported to exercise the second option. P refused to sell, and D's suit for specific performance failed on P's defence of *non est factum* because the document P signed was radically different from what he thought it was (it was an option, not a receipt). As stated by the High Court, the defence of *non est factum* must be kept within narrow limits:

"The class of persons who can avail themselves of the defence [of *non est factum*] is limited. It is available to those who are unable to read owing to blindness or illiteracy and who must rely on others for advice as to what they are signing; it is also available to those who through no fault of their own are unable to have any understanding of the purport of a particular document. To make out the defence a defendant must show that he signed the document in the belief that it was radically different from what it was in fact and that, at least as against innocent persons, his failure to read and understand it was not due to carelessness on his part. Finally, it is accepted that there is a heavy onus on a defendant who seeks to establish the defence."

— *Petelin v Cullen*¹⁷ —

Repayment of a half million dollar loan to a company was secured by a mortgage over Mrs Thompson's home and the loan was guaranteed by family members associated with the company, including Mrs Thompson herself. Mrs Thompson was 75 years old and was suffering the effects of a stroke. When the company defaulted, the mortgagee (P) commenced proceedings for payment and judgment for possession of Mrs Thompson's home. Mrs Thompson was successful in her defence of *non est factum*: when she signed the mortgage and guarantee, she did not have the capacity to understand them so that in truth there was no signature on the documents.

— *PT Ltd v Maradona Pty Ltd*¹⁸ —

Courts may relax the criteria for successfully using the defence of *non est factum* particularly when there is no innocent third party who may be prejudiced.

¶5-691 Remedies for mistake. There are many remedies for mistake at common law, in equity and under legislation.

- (1) *At common law.* As discussed above, only those mistakes affecting the very existence of the contract will make a contract void. If so, the common law may declare a contract void for mistake — common, mutual or unilateral — "ab initio" (from the beginning) if the mistake affects the very existence of the contract. A person to the agreement is not bound by it, and can defend action brought on it. Any money paid can be recovered by action in restitution (¶6-510).
- (2) *In equity.* One of the important maxims (rules) of equity is that "equity follows the law" (¶1-010). This means that if a contract is void at common law for mistake, it will also be void in equity. Equitable

17. (1975) 132 CLR 355 at pp 359-360; (1975) 49 ALJR 239 at pp 241-242.

18. (1992) 25 NSWLR 643, noted (1993) 67 ALJ 295.

remedies for mistake are designed to overcome injustice or hardship and are based on good conscience:

- rescission (cancellation) as in *Solle v Butcher* (¶5-665) and *Taylor v Johnson* (¶5-670);
- restitution, to restore the past, as in *Ingram v Little* (¶5-680) unless third party rights intervene (¶5-685): ¶6-510;
- specific performance, as in *Tamplin v James* (¶5-660): ¶6-400; and
- rectification (correction of a written document): ¶5-695.

Equitable remedies are especially important if there is a reason in conscience why the contract should not be enforced, such as where one person induces the mistake, or deliberately cloaks the mistake of the other, or otherwise behaves unconscionably.¹⁹

- (3) *Under legislation.* Contracts may be rewritten or set aside if induced by mistake caused by:
 - “misleading or deceptive conduct” under sec 52 of the *Trade Practices Act 1974* (Cth) (¶7-250-¶7-287);
 - “unconscionable conduct” under sec 51AA-51AC (¶5-755-¶5-760) (or at common law: (¶5-730), or
 - “false or misleading representations” under sec 53 (¶7-290ff).

¶5-695 Rectification of written agreements. When the parties have agreed on the terms of their contract but by mistake have written them down incorrectly — due to such matters as a clerical error, a mistaken interpretation of a written agreement which fails to embody the true agreement of the parties,²⁰ or an error in draftsmanship — the court, in exercise of its equitable jurisdiction, may order rectification (correction) of the contract: Rectification [is] essentially an equitable remedy to prevent equitable fraud and it [would be] equitable fraud for a person to insist on enforcement of a written contract where there has been a mistake.”²¹

The essence of rectification is to bring the document, which is expressed and intended to follow a prior agreement, into harmony with that prior agreement.

Before an order for rectification can be made, there must be evidence that—

- (1) the parties formed and continued to hold a single corresponding intention on the point in question, whether there is a concluded antecedent agreement or not.

19. *Easyfind (NSW) Pty Ltd v Paterson* (1987) 11 NSWLR 98 at pp 107-108.

20. eg *Winks v WH Heck & Sons Pty Ltd* [1986] 1 Qd R 226.

21. *Macdonald v Shinko Australia Pty Ltd* [1999] 2 Qd R 152, noted at (1999) 73 ALJ 873.

- (2) this intention continued to exist in the minds of both or all parties right up to the moment of execution of the formal instrument over which rectification is sought. No formal communication of the common intention of each party or outward expression of accord is necessary so long as subjective intention can be proved on the balance of probabilities. Even a secret and undisclosed intention may be evidence of intention if it can be proved.
- (3) the document sought to be rectified does not reflect that matching intention but would do so if rectified in the manner requested.²²

¶5-700 Misrepresentation. Often representations are made during contract negotiations which induce the other person to make the contract (¶6-020). For example, representations may be made about:

- the condition of a car;
- the views available from a home unit purchased “off plan” (where the actual building is unseen);
- the likely return on an investment (eg in a partnership: ¶10-600).

If untrue, these representations are called misrepresentations.

There are legal remedies for misrepresentation in many different areas of law. These remedies are independent of each other and parallel, and a plaintiff may choose to enforce some or all depending on factors such as cost and the evidence available. One remedy does not exclude the other:

- (1) Some representations become terms of the contract and are dealt with under contract law (¶6-010ff). If the representation is a term of the contract, the innocent party must elect *either* to sue for damages for breach of contract *or* to rescind for actionable misrepresentation, but not both.
- (2) If a misrepresentation has led to a contract being entered into by mistake, the resulting contract may be void for mistake and can be disaffirmed (¶5-620).
- (3) A misrepresentation may have become a collateral contract (¶6-030).
- (4) A misrepresentation may make a contract voidable and give rise to the equitable remedy of rescission (cancellation) if it is an “actionable” misrepresentation.
- (5) A misrepresentation if innocent or negligent may give rise to a claim for damages in the tort of negligence (¶4-060 and below). A fraudulent misrepresentation may give rise to a claim for damages in the tort of deceit (below).
- (6) Some jurisdictions provide remedies for misrepresentation in misrepresentation legislation (¶5-705) and other statutes such as the

22. *Rectification* (1998) 72 ALJ 933.

Trade Practices Act 1974 (Cth), the Fair Trading Acts (¶7-250ff) and the Corporations Law.

Classes (4) and (5) are considered below; class (6) is considered at ¶5-705.

Rescission for actionable misrepresentation (class (4)). Misrepresentations are classified as a “non-contractual” misrepresentation (minor) or an “actionable” misrepresentation (major). The equitable remedy of rescission (cancellation, revocation) is available if there is actionable misrepresentation:

- (a) “Non-contractual” or “mere” misrepresentation. A minor misrepresentation is a “mere” misrepresentation. This is a statement which is not part of the contract, and has no effect in contract. There is no remedy in rescission unless the misrepresentation is “actionable”. However, even for a mere misrepresentation there may be remedies under tort, under misrepresentation legislation, under the *Trade Practices Act 1974* (Cth) sec 52 (¶7-250) or sec 53 (¶7-290) or under other laws such as for breach of a fiduciary, confidential or special relationship.
- (b) “Actionable”, “operative” or “material” misrepresentation. To be “actionable” under the misrepresentation remedies, the misrepresentation must have actually induced the other person to enter the contract. This means that a person arguing misrepresentation (ie the injured party) must have relied on the representation rather than on that person’s own judgment.²³

Rescission. This is an equitable remedy which allows the innocent person to cancel the contract by rescinding or by raising the misrepresentation as a defence if sued for damages or for specific performance by the other person.

The object of rescission is to restore both parties as nearly as possible to the position they occupied prior to the contract; each party is relieved of its obligations and each can recover benefits conferred on the other party. To achieve this, the party misled can claim an indemnity against any obligations which it may incur, or has incurred, as a result of the contract. However, the right to indemnity is less extensive than the right to damages because the aim of an award of indemnity is to restore the person misled to that person’s previous position and not to cover damages which might flow naturally and reasonably from the injury (¶6-280; ¶6-430).

To justify rescission for actionable misrepresentation, the misrepresentation must be:

- false. P must prove that the misrepresentation is not true.
- of fact, not opinion. Only statements of a past or present fact can give rise to action for misrepresentation. This excludes puffery or sales talk (¶5-080), and statements of intention or future conduct, including a promise as to the future. However, as an exception to this rule, damages for misrepresentation were awarded in the *Esso case* (below) because

23. *Redgrave v Hurd* (1881) 20 Ch D 1; [1881-85] All ER Rep 77.

the service station was entitled to rely on Esso's honestly made opinion on traffic flow based on its special knowledge. A misrepresentation of law is not actionable, because everyone is presumed to know the law.²⁴

- addressed to the person misled.
- intended to induce P to enter the contract. The representation must be material — it did actually induce the contract, and P would not have contracted without it.

Silence does not usually constitute misrepresentation: "The general rule, both of law and equity, in respect to concealment, is that mere silence with regard to a material fact, which there is no legal obligation to divulge, will not avoid a contract, although it operates as an injury to the party from whom it is concealed."²⁵

Silence can constitute a misrepresentation if it distorts a representation made. It can have legal consequences affecting a previous statement:

- if a statement made is a half-truth;
- if a statement was true but became false before the contract was settled;
- if there is a fiduciary relationship between the parties;
- if the contract is a contract of the utmost good faith (such as insurance contracts: see ¶17-310).

Rescission is an equitable remedy, and the right to rescind may be lost in the following situations:

- restitution impossible — the parties cannot be restored reasonably closely to their original positions. For example, substantial alteration of the subject matter of the contract would prevent rescission. Similarly, the right to rescind may be lost by material changes in the positions of the parties. It may be lost by the conduct of the parties after they had knowledge of the misrepresentation. Full rescission may not be possible if it would result in inequity.

— Case examples —

Partial rescission. P supplied ready-mixed concrete to D Pty Ltd under a contract with a guarantee (¶13-360) by V (the director of D Pty Ltd). V applied for and was granted rescission for P's misrepresentation that the guarantee would relate only to future debts of D Pty Ltd, not past debts. The High Court held that V was not entitled to be relieved from all liability under the guarantee as this would leave P with no security. V was still liable under the guarantee for future debts, being bound by the maxim of equity that "he who seeks equity must do equity":

24. Payments made under mistake of law can be recovered in WA: *Property Law Act 1969* (WA) sec 124.

25. *Smith v Hughes* (1871) LR 6 QB 597 at p 604, quoted in *Lam v Ausintel*

Investments Australia Pty Ltd (1989) 97 FLR 458; (1990) ATPR ¶40-990 (silence failed to indicate misleading or deceptive conduct under *Trade Practices Act 1974* (Cth) sec 52: ¶7-250).

“Where, as in this case, the court [ie the court below] has granted equitable relief in the shape of rescission of a contract, the result is to set aside the contract *ab initio*. While equity followed the law in requiring restitution as a condition of rescission where the contract had been wholly or partly executed, it allowed greater flexibility in the basis upon which restitution and accounting between the parties may be ordered. Thus, equity did not require complete restitution of the position which existed before the contract but allowed its remedies, particularly an order for monetary accounts, to be utilised to achieve practical restitution and justice.”

_____ *Vadasz v Pioneer Concrete (SA) Pty Ltd*²⁶ —

P agreed to purchase the goodwill of a smallgoods wholesale business called “Gourmet Goodies” and was induced to enter the agreement partly by certain fraudulent misrepresentations as to the availability of a number of product lines. The court held that although P could not rescind because it was not possible to substantially restore the parties to their pre-contractual position, P was entitled to an award of damages in the tort of deceit.

_____ *Jolly Good Foods Pty Ltd v Rolex Pty Ltd*²⁷ —

- unconscientious conduct of the plaintiff, as rescission is a discretionary remedy.
- affirmation — the injured party with full knowledge of the misrepresentation has expressly or impliedly affirmed the contract, such as by accepting a repair offer by the defendant.
- third party rights. If a third party has acquired rights under the contract in good faith and for valuable consideration, the right to rescind may be lost. The original contract is voidable for misrepresentation, not void, so good title can pass to the third person.
- executed contracts. If the contract has been executed (completed), rescission may be refused under the “rule in *Seddon’s case*”.²⁸ There is some doubt whether rescission for innocent misrepresentation can apply to a contract for sale or lease of property where the contract is executed, although the courts have taken the view that the remedy of rescission for innocent misrepresentation is available (at least) in the case of an executed contract for the sale of goods: in one instance, a purchaser of a horse on the basis of an innocent misrepresentation as to its sire was entitled to rescind the contract even though the contract had been executed.²⁹

26. (1995) 184 CLR 102 at p 111, cited in, eg, *NZI Capital Corporation Ltd v Poignand* (1997) ATPR ¶41-586; ¶5-730.

27. (1984) ASC ¶55-296, (1986) ASC ¶55-451.

28. *Seddon v North Eastern Salt Co Ltd* [1905] 1 Ch 326; cf *Senanayake v Cheng* [1965] 3 All ER 296, noted at ¶10-600;

overturned by the misrepresentation legislation in SA and the ACT, and in the *Sale of Goods Act 1923* (NSW) sec 4(2A).

29. *Leason Pty Ltd v Princes Farm Pty Ltd* [1983] 2 NSWLR 381; see also *Graham v Freer* (1980) 35 SASR 424 (sale of yacht).

- lapse of time. The right to rescind may be lost unless the plaintiff acts within a reasonable time.

Remedies in tort for misrepresentation (class (5)). Tort remedies are parallel remedies, and are separate from and independent of rescission for contractual misrepresentation as discussed above (class (4)), and the statutory remedies considered below at ¶5-705.

Remedies in tort for misrepresentation can be classified as follows:

Innocent misrepresentation: no remedy in tort. An innocent or non-fraudulent misrepresentation is a misrepresentation which leads to the making of a contract. It is “innocent” because it is not negligent or fraudulent. An innocent misrepresentation can misrepresent even if made with the honest but mistaken belief that facts are true both at the time the contract was made and at the time it was entered into. For example, a person may give wrong information honestly and reasonably, without fraud or negligence. There is no remedy for innocent misrepresentation in tort (unless it is negligent), and the only remedies are under the misrepresentation statutes and the other statutes discussed below at ¶5-705.

Negligent misrepresentation: tort of negligence. The general rule that an innocent misrepresentation does not give rise to action does not apply where a fiduciary (¶9-770), confidential or special relationship exists. Since the decision in *Hedley Byrne & Co Ltd v Heller and Partners Ltd* (¶4-240), the “special” relationship defined negatives the pre-existing law with regard to innocent but negligent misrepresentations in the law of tort.

— Case example —

Esso (D) planned a petrol station on a busy street in the centre of a provincial city. The local council insisted that the petrol station be built “back to front” with the showroom on the main street, and the driveway and pumps at the back, only accessible by side streets. D built the petrol station according to these council requirements, but negligently D did not revise down its estimated annual consumption of petrol when it leased the service station to P as a “Grade A” site. Predictably, D’s estimates proved to be overstated. P recovered damages for D’s negligent misrepresentation: a person who induces by a negligent mis-statement another person to enter into a contract with them or induces them to enter into a contract with a third person, may be liable in damages. The duty of care is a term *implied* in a contract (as in this case: ¶6-110) and it is *imposed* under the tort of negligence (also as in this case: ¶4-260).

— *Esso Petroleum Co Ltd v Mardon*³⁰ —

The law of negligent misrepresentation is now a major growth area in the law of tort, and is discussed further at ¶4-230ff.

Fraudulent misrepresentation: tort of deceit. A fraudulent misrepresentation is a false representation of a material fact, actionable if acted upon by P, if

30. [1976] 1 QB 801; [1976] 2 All ER 5.

made by D: (1) knowingly, or (2) without believing in its truth, or (3) recklessly, careless whether it be true or false.³¹

Fraudulent conduct forms the basis of the tort of deceit, and the remedy of the injured party is not action in contract but action in the tort of deceit. Indeed, the injured party may well wish to carry on with the contract if it is of some benefit, as well as suing for damages in tort, whether the representation is a term of the contract or not. If the contract has not yet been completed the innocent party may repudiate the contract and sue for restitution (¶6-510). If the other party attempts to enforce the contract, the innocent party can raise the fraud as a defence and counter-claim for damages (as assessed in the law of tort: ¶4-180—¶4-215). Whether non-disclosure and concealment amount to fraudulent misrepresentation depends on subjective judgments and may be difficult to prove.

Misrepresentation: other remedies. Misrepresentation may be actionable under the *Trade Practices Act* if caused by:

- “misleading or deceptive conduct” under sec 52 (¶7-250-¶7-287);
- “unconscionable conduct” under sec 51AA-51AC (¶5-755-¶5-760) (or at common law: (¶5-730), or
- “false or misleading representations” under sec 53 (¶7-290ff).

In making an order under, for example, sec 87(2) of the *Trade Practices Act*, the court is not limited by — although it may have regard to — the general law on the right to rescind for misrepresentation.³²

¶5-705 Misrepresentation legislation. Because the common law gave the plaintiff who had relied on an innocent representation no legal remedy, remedial legislation was passed in some jurisdictions:

(1) *Misrepresentation Act 1972* (SA) and *Law Reform (Misrepresentation) Act 1977* (ACT). This legislation changed the law by imposing new and serious liability on anyone making a misrepresentation of fact — even if innocent. It is modelled on the equivalent English legislation of 1967,³³ on which Lord Denning MR commented:

“... But how different from times past! For years he [the representor] was not liable in damages at all for innocent misrepresentation: see *Heilbut, Symons & Co v Buckleton*.³⁴ Quite recently he was made liable if he was proved to have made it negligently ... But now with this Act he is made liable, unless he proves, and the burden is on him to prove, that he had reasonable ground to believe and did in fact believe that it was true.”³⁵

31. *Derry v Peek* (1889) 14 App Cas 337; [1886-90] All ER Rep 1.

32. *Software Integrators Pty Ltd v Roadrunner Couriers Pty Ltd* (1997) ATPR (Digest) ¶46-177; ¶8-860.

33. *Misrepresentation Act 1967* (UK).

34. [1913] AC 30.

35. *Howard Marine & Dredging Co Ltd v A Ogden & Sons (Excavations) Ltd* [1978] 2 All ER 1134, per Lord Denning MR at p 1142.

In the words of sec 4(1) of the ACT Act (SA sec 7(1) is to the same effect):

“4(1) Where a person enters into a contract after a misrepresentation has been made to him by—

- (a) another party to the contract;
- (b) a person acting for, or on behalf of, another party to the contract; or
- (c) a person who receives any direct or indirect material advantage as a result of the formation of the contract,

and as a result of so entering into the contract he suffers loss, any person (whether or not he is the person by whom the misrepresentation is made) who would be liable for damages in tort in respect of the loss had the misrepresentation been made fraudulently, shall, subject to this section, be so liable, notwithstanding that the misrepresentation was not made fraudulently.”

The Misrepresentation Acts provide as remedies:

- (a) **damages**, as if the representation were fraudulent (SA sec 7(1); ACT sec 4(1)), subject to defences of truth, reasonable grounds for belief and mistaken identity (SA sec 7(2); ACT sec 4(2)), and it is no defence that liability is expressly excluded unless “fair and reasonable” (SA sec 8; ACT sec 6); and/or
- (b) **rescission**, if it is “just and equitable” to treat the contract as if it were never binding. The Act has removed some traditional bars to rescission (that the misrepresentation has become a term of the contract, that the contract has been performed — that a transfer, etc has been registered: SA sec 6; ACT sec 3), although others have been retained (restitution impossible, contract affirmed, undue delay or unfairness). Section 7(3) (SA); ACT sec 5(1) empowers the court to bar rescission and order damages instead if “fair and reasonable” to do so. The right to rescind under the misrepresentation legislation is not lost by “acceptance of the goods” under the sale of goods legislation.³⁶

— Case examples: SA and ACT —

The purchasers of a franchise to market burglar alarms were entitled to rescind the contract due to the franchisor’s misrepresentation that there were no competitors in their market. The purchasers learned that this was incorrect and were awarded damages because the misrepresentation had induced the making of the franchise contract. The misrepresentation also breached the *Trade Practices Act 1974* sec 52 (¶7-250).

— *Crawford v Parish*³⁷ —

A gold miner gave P an option over his mine, and entered a bet with P that certain mining leases would be granted by the government during the option period. When no leases were granted, P failed in its action against the miner

36. *JAD International Pty Ltd v International Trucks Australia Ltd* (1994) 50 FCR 378; ¶7-025.

37. (1991) 105 FLR 361; (1992) ATPR (Digest) ¶46-087; ¶9-986.

for the latter's representation about them. The bet was an expression of support for the miner's confidence about the leases, not a representation, and P could not sue under the *Misrepresentation Act 1972* (SA) sec 7.

*Tomlinex Pty Ltd v Collins*³⁸ —

(2) *Goods Act 1958* (Vic). Section 100 of the *Goods Act* follows the wording of the UK and the SA *Misrepresentation Acts* in providing for rescission of a contract for the sale of goods where an innocent misrepresentation has been made, provided that notice is given to the seller within a reasonable period after acceptance of the goods.³⁹

(3) *Sale of Goods Act 1923* (NSW). As amended in 1987 following recommendations of the New South Wales Law Reform Commission, sec 4(2A) expressly preserves for sale of goods contracts the rules of equity relating to rescission for misrepresentation. Further, the right to rescind is not necessarily precluded because the contract has been performed, or by the fact that the misrepresentation has become a term of the contract, or that the goods have been accepted (unless there are words or conduct which would amount to affirmation under the general law: sec 38(2), as amended in 1987).

(4) *Trade Practices Act 1974* (Cth). Misrepresentation cases may also be brought under the *Trade Practices Act* for "misleading or deceptive conduct" under sec 52, "unconscionable conduct" under sec 51AA-51AC (and unconscionable conduct at common law) or as "false or misleading representations" under sec 53: ¶5-691: "In the appropriate circumstances, [sec 52] operates to provide an action for damages for innocent misrepresentation."⁴⁰

The *Trade Practices Act* does not require evidence that someone has acted on the misrepresentation: mere capacity or tendency to mislead is sufficient for the remedies in the Act. For example, a misrepresentation which may not be actionable at common law, such as an incorrect assessment of insurance law, has been held to breach sec 52 and 53(g) of the Act.⁴¹ These parallel remedies for innocent misrepresentation are discussed at ¶7-250ff and ¶8-840.

(5) *The Fair Trading Acts*⁴² also contain provisions relating to actions resulting from the making of certain types of false or misleading statements (¶7-230).

38. (1995) ATPR (Digest) ¶46-139, on appeal from *Tomlinex Pty Ltd v Candoura Pty Ltd* (1994) ATPR ¶41-302.

39. The purchaser does not lose the right to rescind for misrepresentation under the *Misrepresentation Act 1972* (SA) and the *Law Reform (Misrepresentation) Act 1977* (ACT) even after accepting goods within the *Sale of Goods Act* (¶7-025).

40. Gleeson, Chief Justice AM, *Individualised justice — the Holy Grail* (1995) 69 ALJ 421 at p 427. "[U]nder sec 52 and 82 [there may be] a remedy

in damages for what the common law would classify as innocent misrepresentation": *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31 at p 38; (1993) ATPR ¶41-203 at p 40,849.

41. eg *SWF Hoists and Industrial Equipment Pty Ltd v State Government Insurance Commission* (1990) ATPR ¶41-045.

42. 1999 (Vic), 1987 (NSW), (SA), (WA), 1989 (Qld), 1990 (Tas), 1992 (ACT) and the *Consumer Affairs and Fair Trading Act 1990* (NT).

There is also misrepresentation legislation in specific areas, for example in the area of motor car traders (§7-510—§7-640).

§5-710 Undue influence. Where a person makes an agreement, transfers property, etc in circumstances indicating absence of a free and deliberate judgment, the equitable doctrine of undue influence may enable the court to set aside the agreement, etc. The presumption of undue influence mainly arises where the parties are in a relationship implying mutual confidence and/or influence. Neither a fiduciary relationship (§9-770) nor a relationship of inequality of bargaining power (§5-730) of itself gives rise to a presumption of undue influence.

However, where a misuse of this relationship and/or confidence can be shown, the court in its equitable jurisdiction may set aside a transfer of property or other contract if there is evidence of an unconscionable use of any special capacity or opportunity existing between the parties such as to affect the transferor's will or freedom of judgment. In other words, contracts made by the exercise of undue influence are not void but voidable at the option of the party influenced. In some cases, the relationship between the parties is such as to create a presumption of undue influence unless the opposite is established — such cases include those of parent and child, solicitor and client, doctor and patient, priest and parishioner. There is no presumption of undue influence in the case of the relationship of accountant/financial adviser and client.⁴³

— *Case examples* —

P joined the Sisters of the Poor on the introduction of her priest the Rev Nihill and she bound herself to observe the Sisters' rules of poverty, chastity and obedience. She made a will giving all her property to the lady superior (D), and made annual gifts to her. After eight years, P left the sisterhood, and revoked her will. Six years after leaving she sued D to recover the amounts of the annual gifts alleging that they were made under undue influence. The court held that although P had voluntarily and with independent advice entered the sisterhood, she was under the influence of D, the Rev Nihill and the rules of the Sisters. The court recognised that P would have been entitled to any of her property still in the control of D, but not the amounts spent on the purposes of the sisterhood while she was a member. However, her six year delay in bringing action disqualified her claim under the equitable doctrine of "laches": §6-500.

— *Allcard v Skinner*⁴⁴ —

The customer farmer had given three guarantees (§13-360) to the plaintiff bank to secure finances for his son's business which was in difficulty. Despite the injection of funds facilitated by the guarantees, the son's business collapsed and the bank brought proceedings to gain possession of the farm in order to sell it. The order for the plaintiff was reversed by the Court of Appeal on the grounds of undue influence.

— *Lloyds Bank v Bundy*⁴⁵ —

43. *Cowen v Piggott* [1989] 1 Qd R 41.

45. [1975] QB 326; [1974] 3 WLR 501.

44. (1887) 36 ChD 145.

The *Lloyds Bank case* is considered to be limited to its specific facts, and does not indicate that “normal” banking transactions cross the line into the area of confidence. The customer farmer was elderly, had dealt with the local branch for many years, had not been fully informed of the seriousness of his son’s position, and had not received independent legal advice. Lord *Denning’s* reason for deciding in favour of the customer on the wider grounds of the inequality of bargaining power was rejected in the *National Westminster case* noted below, in favour of the judgments of the other two judges, namely, that the bank had breached its fiduciary relationship (§9-770) with the customer in not fully apprising him of the situation, and not recommending that he seek independent legal advice.

— *Case example* —

X was an old man, wholly illiterate and of less than average intelligence, with little or no experience of, or capacity for, business. After his wife died, he decided to leave his cottage to a relative under his will and to exclude his son; after this relative had looked after him for a while, he decided to transfer the property to the relative and the transfer was executed in the office of the relative’s solicitor in consideration of natural love and affection (§5-497). He had no independent legal advice. After his death, his son was successful in having the transfer set aside for undue influence.

— *Johnson v Buttress*⁴⁶ —

There were a number of factors indicating that undue influence was at work: the old man did not have the benefit of independent legal advice and the only solicitor involved in the transfer was that of the transferee. Advice need not have been from a solicitor, as any independent advice might have indicated that he knew exactly what was going on; advice from a friend or another relative might have been enough. The fact that he was elderly, illiterate and weak-minded also contributed to the presumption of undue influence and made the necessity of independent advice even more imperative to rebut it. The presumption of undue influence can be rebutted by a factor as slight as evidence of independent advice or other means of indicating that the decision in question resulted from the exercise of free will.

The presumption of undue influence will not arise without evidence that the transaction itself was wrongful in that it amounted to taking an unfair advantage of the other person even though there may have been a relationship of influence and/or confidence. The relationship of bank and customer does not ordinarily give rise to a presumption of undue influence, but if there has been undue influence between customers such as by husband over wife, the bank may be affected by the husband’s undue influence if it has not ensured that the wife understands the transaction and that her consent was true and informed.

46. (1936) 56 CLR 113.

— *Case example* —

Mr and Mrs O'Brien agreed to sign a second mortgage over their family home as security to increase the overdraft given by the bank to Mr O'Brien's company. Mrs O'Brien, relying on Mr O'Brien's false representation that the overdraft was limited to £60,000 and would only last for three weeks, signed the mortgage without reading it. When the company's overdraft exceeded £154,000, the bank took action to enforce the mortgage by taking possession of the family home. The court held that in these circumstances Mrs O'Brien was entitled to special protection in equity and that the second mortgage was not enforceable against her over the amount of £60,000. This case does not void loans given on the security of the family home, as it is essential that "a law designed to protect the vulnerable does not render the matrimonial home unacceptable as security to financial transactions."

*Barclays Bank Plc v O'Brien*⁴⁷

The lesson of this and other such cases is that the bank must insist that the wife obtain independent legal advice before the transaction. If the husband is acting as agent of the bank in getting the document signed, the bank may be affected by a presumption of undue influence.

¶5-720 Duress. Duress means pressure or compulsion to force a person to do something against their will. A contract made under duress is voidable by the person coerced. Such illegitimacy includes the threat to do something unlawful such as actual or threatened violence, imprisonment, or the bringing of unfounded criminal proceedings. The target of the duress need not be the plaintiff; it is duress if threats are made concerning immediate family and near relatives.

Duress may be found to influence the creation of a contract although it need not be the only motivation to contract. Hence, in *Barton v Armstrong* the court observed that:⁴⁸ "though it may be that [P] would have executed the documents even if [D] had made no threats ... the threats and unlawful pressure in fact contributed to his [P's] decision to sign". The coercing party D could not show that duress was not a contributing cause to P's decision to contract.

— *Case example* —

Following an auditor's report which showed evidence of misappropriation of some \$50,000 by P from D, the auditor on D's instructions threatened to report to the police unless P signed a contract to repay. P was unsuccessful in having the contract set aside for duress: the threat of criminal prosecution was not enough to set aside the contract for duress as the amount actually was owing, P had received time to pay (ie valuable consideration for entering

47. [1994] 1 AC 180 at p 188 (HL); compare "The plethora of cases may suggest that all is not well with the O'Brien principle": Mason, A, *The impact of equitable*

doctrine on the law of contract (1998) 27 Anglo-American Law Review 1.

48. [1976] AC 104 at p 120.

the contact), and there was no impropriety on D's part in the sense of an agreement to stifle a prosecution.

— *Scolio Pty Ltd v Cote*⁴⁹ —

Economic duress. In addition to duress to the person and duress to goods, the law recognises economic duress in the form of “commercial pressure” forcing the consent of B to acquiesce to the conduct dictated by A.

— *Case example* —

When they relocated their business, Mr and Mrs D sold their family home and purchased a new home. The fact that their bank refused to release the sale proceeds unless Mr and Mrs D signed security documents (guarantees: ¶13-360—¶13-370) on behalf of their companies in favour of the bank was not economic duress. In the words of *McHugh* JA (as he then was), “The proper approach in my opinion is to ask whether any applied pressure induced the victim to enter into the contract and then ask whether that pressure went beyond what the law is prepared to countenance as legitimate? ... Even overwhelming pressure, not amounting to unconscionable or unlawful conduct, however, will not necessarily constitute economic duress.”

— *Crescendo Management Pty Ltd v Westpac Banking Corporation*⁵⁰ —

This case rejected the “overbearing the will” test of English cases⁵¹ on the basis that the person subject to economic duress usually has full knowledge and chooses to submit to the demand or pressure.

Conduct that does not amount to economic duress may still be actionable as fraud or misrepresentation (¶5-700), undue influence (¶5-710) or unconscionability (¶5-730).

— *Case example* —

“*Lawful act duress*”. P paid D's invoice under protest when D threatened to stop P's credit facilities. P later brought proceedings for repayment on the ground that D had been paid under duress. P was unsuccessful. The court was not prepared to extend duress to “lawful act duress” by D in a commercial context in pursuit of a genuine claim because this would introduce an undesirable element of uncertainty in the commercial bargaining process, and it would enable settled accounts to be reopened when the parties fell out.

— *CTN Cash and Carry Ltd v Gallaher Ltd*⁵² —

¶5-730 Unconscionable contracts. Contract law assumes what is not always the case — that the contracting parties meet as equals. In fact,

49. (1992) 6 WAR 475. The contract was contained in a deed.

50. (1988) 19 NSWLR 40 at p 46.

51. eg *Universe Tankships Inc of Monrovia v International Transport Workers Federation* [1983] 1 AC 366.

52. [1994] 4 All ER 714, noted (1995) 69 ALJ 320.

one party often has superior bargaining power and may be able to force the other into a harsh or unconscionable contract.

For hundreds of years, equity law had granted relief against harsh and unconscionable contracts considered usurious — such as those extracted from expectant heirs, where young nobles sold their expected inheritances or entered outrageous borrowing arrangements with totally inadequate consideration.

Courts abandoned this practice in the nineteenth century under the influence of a prevailing government policy of non-interference in economic activity.¹ It was thought that the law should not interfere with the enforceability of contracts freely entered, and that people have only themselves to blame for entering a harsh and unconscionable contract.

The courts are increasingly going beyond the proposition that a person is bound to the bargain, if it can be shown that unfair advantage has been taken. Rewriting of contracts by the courts to ensure that the parties play fair has taken place under devices such as lack of mutuality,² failure of consideration, construction or analysis of the contractual terms,³ misrepresentation (¶5-700), duress (¶5-720), undue influence (¶5-710), unconscionability in equity law and under legislation (¶5-755—¶5-760), misleading or deceptive conduct (*Trade Practices Act 1974* (Cth) sec 52: ¶7-250ff) and the false representation provisions of the *Trade Practices Act* (sec 53: ¶7-290ff).

— Case examples —

In 1966, a then unknown 21-year-old songwriter (P) entered a contract with music publisher D. D's "standard form" publishing contract included terms to the effect that the publisher took full copyright of the composer's compositions but had no positive obligation to do anything with it. The contract was to run for five years, and another five years if royalties exceeded £5,000, and P had no right to terminate the contract. After four years, P sought a declaration that the contract was contrary to public policy and void. The court held in P's favour that the contract was unduly restrictive and that it failed according to the principles of restraint of trade (¶5-840ff). In so deciding, one of the judges used the language of unconscionability: in deciding whether to relieve promisor P of his obligations under the contract, the role of the courts was "to assess the relative bargaining power of the publisher and the songwriter at the time the contract was made and to decide whether the publisher had used his superior bargaining power to exact from the songwriter promises that were unfairly onerous to him '... If you want these goods or services at all, these are the only terms on which they are obtainable. Take it or leave it.'"

1. Courts continued to grant relief against penalty clauses (¶6-490), forfeiture (¶3-770) and contracts in restraint of trade (¶5-840).

2. eg the mistake cases: see ¶5-620—¶5-690.

3. eg *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1988] 2 WLR 615; [1988] 1 All ER 348 (¶6-210), or the judicial attack on exclusion clauses (see ¶6-180ff).

This particular standard form contract was judged “a classic instance of superior bargaining power”.

_____ *A Schroeder Music Publishing Co Ltd v Macaulay*⁴ _____

Unconscionability case law

The High Court applied the equitable doctrine of unconscionable conduct where two elderly parents of Italian origin were persuaded by their builder son, and the local branch of the bank where he was a major customer, to guarantee (¶13-360) and mortgage a property to the bank as security for the liability of their son's company to the bank. Because of the failure of the son, and the bank, to disclose the true position of his company, the parents mistakenly believed that their liability was limited to \$50,000 for a period of six months. When their liability turned out to be \$240,000, the parents were successful in having the mortgage and guarantee set aside on the basis that they would not have signed had they known the state of the company's account and its insolvency. The High Court confirmed that the bank should have disclosed the true position of the son's company, and that it was guilty of unconscionable conduct in obtaining the mortgage and the guarantee from the parents, as it should have been evident that they were under a special disability by reason of their age and limited competence in the use of the English language:

“A transaction will be unconscientious within the meaning of the relevant equitable principles only if the party seeking to enforce the transaction has taken unfair advantage of his own superior bargaining power, or of the position of disadvantage in which the other party was placed. The principle of equity applies ‘whenever one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands.’ ”

_____ *Commercial Bank of Australia Ltd v Amadio*⁵ _____

Not every disadvantageous transaction can be called unconscionable. Elderly parents guaranteeing repayment to the bank of a loan to their daughter and son-in-law may find the guarantee disadvantageous if called up, but the transaction may only be considered unconscionable if, as in the *Lloyds Bank case* (¶5-710), an established bank/customer relationship of trust, reliance and

4. [1974] 1 WLR 1308, per Lord Diplock at pp 1315-1316. The songwriter's existing copyrights would remain with the publishers for the period agreed previously but the writer was now free to sign new terms with somebody new.

5. (1983) 151 CLR 447 at p 459, noted, eg, (1984) 58 ALJ 51 (¶16-060); Bear, P, *Current developments: current issues on the law of guarantees* (1988) 10 LSB 263.

proper performance of duties is abused by the bank in its advice and information to the customer.⁶

The equitable jurisdiction to set aside a transaction as unconscionable requires a "special disability" in one party in relation to the other, and "[t]he whole system of equity jurisprudence proceeds upon the ground, that a party having a legal right, shall not be permitted to avail himself of it for the purposes of injustice, or fraud or oppression, or harsh and vindictive injury".⁷

— Case examples —

P, a twice-divorced middle-aged male solicitor, was "completely in love" with and infatuated by D. Believing that D and her two children were to be evicted from their rental property, P paid some \$60,000 so that D could buy a house to live in. The High Court found that at the time of the gift, P was under a special disadvantage in dealing with D due to his love for her, and that she had exploited the disadvantage with the false "atmosphere of crisis" about the supposed eviction so as to unconscientiously manipulate P to part with \$60,000. This was not a case of an imprudent gift in her favour, and D was found guilty of unconscionable conduct in getting and retaining the gift.

*Louth v Diprose*⁸ —

P, a widow in her mid 40s, was persuaded by her new friend to mortgage some of her land so that he could develop it for the profit of both of them. Without P's knowledge, her friend used the finance secured by P's land for his own purposes including payment of his overdue debts to his bank. P gained an order voiding the bank's mortgage over the land under the *Amadio* principle (above) due to her "special disadvantage" — the "disparity of knowledge" between P and the bank. Because the bank manager knew that the purpose of the finance was largely to repay her friend's debt to the bank, it was unfair for the bank to take her mortgage given in the belief that it was for the development of her property when in reality the bank knew otherwise.

*Begbie v State Bank of New South Wales Ltd*⁹ —

P agreed to buy units in a unit trust to invest in the construction of a retirement village. Later P agreed to grant a mortgage over her home to support the project to a maximum of \$250,000. When the trustee of the unit

6. Guarantee by the elderly parent-in-law set aside for unconscionability: *National Australia Bank Limited v Nobile* (1988) ATPR ¶40-856, noted (1989) 63 ALJ 429. However, the guarantees in this case by the parents were set aside under *Trade Practices Act 1974* (Cth) sec 87 (¶7-850, ¶8-860) for the misleading and deceptive conduct of the bank manager (sec 52: ¶7-250ff) in representing that business was trading satisfactorily.

7. Story, J, *Commentaries on Equity Jurisprudence*, London, Stevens and

Haynes, 2nd English edition, 1892, para 1316.

8. (1992) 175 CLR 621; (1993) 67 ALJR 95; discussed, eg, Cockburn, T, *Solicitors in love: a new category of unconscionability* (1995) 25 QLSJ 291.

9. (1994) ATPR ¶41-288. The claim for unconscionability under the TPA was unsuccessful: ¶5-755. Refer to the Code of Banking Practice at ¶16-041 and the bank/customer relationship at ¶16-060.

trust later defaulted, the mortgagee wished to enforce the guarantee against P and to obtain possession of her home under the mortgage. P was successful in arguing that it would be unconscionable for the mortgagee to enforce the guarantee and mortgage, and they were set aside. A new guarantee of \$25,000 was ordered on the grounds that P had been in an inferior bargaining position: P was in a position of special disadvantage in relation to the transaction, lacked independent legal advice and was unaware of unusual features of the loan agreement. Rescission was not possible because the parties could not be restored to their prior position as the project had already gone ahead (¶5-700). However, it was appropriate to make an order to limit P's exposure to what P would have agreed if P had received independent legal advice at the time (\$25,000).

*NZI Capital Corporation Ltd v Poignand*¹⁰ —

Mr and Mrs P mortgaged their family home to the bank with an "all moneys" mortgage¹¹ to secure a loan to Mr P for use in his business as a dealer in gold. Mrs P later signed four guarantees to the bank, secured by the existing mortgage, as security for further finance for Mr P's business. Mrs P was a "capable and presentable professional" (a physiotherapist) and understood that the guarantees were limited to Mr P's company's overdraft to permit the purchase of gold. Mrs P was a "volunteer" to Mr P's transaction. The bank's whole process took less than a minute, the bank offered no explanation of the transaction and it did not recommend that Mrs P obtain independent legal advice.

After Mr and Mrs P divorced, Mrs P was successful in having the bank guarantees set aside. The High Court followed the principle in *Yerkey v Jones*¹² of the special wives' equity — which gave special protection to wives in these situations — and confirmed that it was not outdated despite the advances of women in Australian society today. The court recognised that the advances of women are more apparent than real and that economic and emotional power imbalances still exist in many marriages. The court held that the principle in *Yerkey v Jones* had not been subsumed by the principles of unconscionability as set out in the *Amadio* case, and that unconscionability is a much wider concept than the specific situation covered by *Amadio*. Therefore the principle in *Yerkey v Jones* could be regarded as a specific species of a much wider genus of unconscionability.

*Garcia v National Australia Bank Ltd*¹³ —

Widow and daughters v nephew. Bill York's widow and daughters successfully challenged his agreement to transfer farming land worth about \$700,000 to his nephew Neil for \$150,000 with a deed of forgiveness of debt (¶5-040) of about \$550,000. At the time the agreement was made, Bill was 84 and his condition was described as fragile and elderly. The same local solicitor acted for all parties, and Bill received no independent legal advice. Bill was disappointed in his four daughters and sons-in-law, and he relied heavily on Neil, who had worked with him for 25 years, treating him like the son he

10. (1997) ATPR ¶41-586.

11. ie to secure "all moneys" owing, not just a specific amount.

12. (1939) 63 CLR 649.

13. (1998) 72 ALJR 1243, noted (1999) 73 ALJ 170; Lang, AD, *High Court wipes out sexually transmitted debt* (1998) 36(8) LSJ 50.

had never had. There was evidence that Bill was in a position of disadvantage which opened him to exploitation by Neil.

The transfer, which was initiated by Neil, was held to be an “improvident disposition which was neither fair nor just and reasonable”. The High Court held that the transfer to Neil was not made in good conscience and it was unconscionable for him to retain the benefit of the improvident transaction. The deed of forgiveness of debt was set aside pending a determination of an appropriate price by the Supreme Court, and in the meantime the High Court confirmed that the estate had a vendor’s lien (¶13-280) over the property until then.

*Bridgewater v Leahy*¹⁴ —

Mr and Mrs D, who were experienced proprietors, managers and developers of retirement villages, used the equity in their home to borrow \$71,000 at 20% from P for one month secured by a registered third mortgage over their home. When they did not repay, P capitalised the loan so that after 19 months, the loan, interest, and interest on interest stood at \$2.7m. Holding the terms of the mortgage to be unconscionable, the court rewrote the mortgage to 15%, excluded capitalisation and ordered D to pay arrears of \$292,000.

*Planet Securities Unit Trust v Dalrymple*¹⁵ —

In the words of the High Court,¹⁶ “unconscionability works in two ways. In its strict sense, it provides the justification for setting aside a transaction. More loosely, it provides the justification for not setting aside the transaction in its entirety or in doing so subject to conditions, so as to prevent one party obtaining an unwarranted benefit at the expense of the other.”

¶5-755 Unconscionability legislation: Commonwealth provisions. Part IVA (sec 51AAA–51AC) of the *Trade Practices Act 1974* (Cth) prohibits a corporation or other person (see ¶7-220) from engaging in unconscionable conduct.

Section 51AA defines unconscionability according to “the unwritten law, from time to time, of the States and Territories” (ie current case law). It therefore applies the principles of the *Amadio case* (¶5-730) to business v business disputes, and in the view of some commentators has made an “unconscionable” interference with the accepted principles of the sanctity of contract.¹⁷

Section 51AB prohibits unconscionable conduct especially in the supply of goods or services — acquired for “personal, domestic or household use

14. (1998) 72 ALJR 1525, noted (1999) 73 ALJ 112.

15. [1999] QSC 204; ¶14-240.

16. *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 69 ALJR 678 at p 684.

17. As criticised by, eg, Baxt, R, *Reform of the law of unconscionable conduct: redressing the balance or undermining legal certainty* (1992) 3 JBFLP 84.

or consumption” (sec 51AB(5))¹⁸ — involving a corporation or other person on the one hand and a “consumer” on the other. To help determine what is unconscionable under sec 51AB, the *Trade Practices Act* lists the following factors to which the court may have regard:

- the relative strengths of the bargaining positions of the corporation and the consumer (sec 51AB(2)(a));
- the fine print — whether the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation (sec 51AB(2)(b));
- comprehensibility — whether the consumer was able to understand any documents relating to the supply of the goods or services (sec 51AB(2)(c));
- whether any undue influence, pressure or unfair tactics were applied (sec 51AB(2)(d)); and
- the market test — the amount for which and the circumstances under which the consumer could have acquired identical or equivalent goods or services elsewhere (sec 51AB(2)(e)).

“Special disability” of one party gives rise to a *prima facie* case of unconscionability. Examples of “special disability” include ignorance, illiteracy or lack of education, poverty or need of any kind, age, infirmity of body or mind, drunkenness, or lack of assistance or explanation where necessary.¹⁹

Market practices: high risk situations. In the view of the ACCC, the following four situations involve a high risk of encouraging or condoning unconscionable conduct:

- (1) where the stronger party knew, or ought to have known, that the consumer/weaker party did not fully understand the transaction;
- (2) where there is no real opportunity for the weaker party to bargain;
- (3) where a contract is extremely one-sided; and
- (4) where the sales techniques, by their very nature, produce a disadvantage to the other party.

Unconscionable conduct under sec 51AA and 51AB is actionable under only two sections of Part VI — an injunction under sec 80 (¶8-810) and an order to rewrite a contract under sec 87 (¶8-860).

— *Case examples: business v business unconscionability* —

Ultra Tune Auto Service: “We do it all”. Ultra Tune supplied one of its franchisees (¶9-985) with a computer software accounting package without disclosing that it contained a lock-out code. When this was activated on a

18. eg this does not include bank finance by way of overdraft to assist a corporation to undertake the commercial development of real estate. Hence the *Trade Practices Act* claim in *Begbie v State Bank of New*

South Wales (1994) ATPR ¶41-288 was unsuccessful: ¶5-730.

19. eg ACCC, *Guide to unconscionable conduct in business transactions*, 1998.

pre-determined date, the franchisee was unable to use the software system unless agreeing to sign a revised franchise agreement with a higher royalty fee. The ACCC alleged that this was unconscionable under the TPA as the franchisee was unreasonably denied access to its own client and financial information (¶9-987). Ultra Tune signed legally enforceable undertakings with the ACCC that it would continue to supply passwords to franchisees during their franchise agreements, fully inform franchisees about the conditions of the franchise and not place franchisees under unconscionable pressure when negotiating franchise terms. Ultra Tune also agreed to pay for trade practices seminars for all its franchisees.

*Ultra Tune Australia Pty Ltd*²⁰ —

Bank guarantees. P contracted to carry out construction work for D, and as part of the contract, D required P to obtain bank guarantees (¶13-360) to secure performance of P's contractual obligations.²¹ When P's side of the contract was substantially complete, D threatened to call up the bank guarantees in full unless P accepted within three days an offer by D to pay the outstanding invoices less 25%. P alleged that D, in calling up the guarantees without the belief that it had any right to do so, was engaging in unconscionable conduct within the meaning of the general law — which was in breach of sec 51AA. (P also alleged breach of contract and fraud.) The court issued injunctions under sec 80 to restrain D: "[D's] conduct based on its legal rights ... is, according to ordinary human standards, quite against conscience".

*Olex Focas Pty Ltd v Skodaexport Co Ltd*²² —

The TPA and State/Territory unconscionability legislation does not apply to insurance contracts, only pre-contract *conduct*: ¶17-310.²³

As from 1998, Part IVA does not apply to unconscionability with reference to financial services as this law has been transferred to the *Australian Securities and Investments Commission Act 1989* (Cth) (sec 51AAB), administered by ASIC.²⁴

20. Reported ACCC Journal, Issue 3, June 1996, p 21.

21. The guarantees were not performance bonds. They were bank guarantees in respect of the mobilisation and procurement advances made by D which had been largely repaid by P: there would have been no unconscionability if D had called up the guarantees to cover only the balance of the advances from D which were outstanding by P.

22. (1997) ATPR (Digest) ¶46-163, criticised (1997) 71 ALJ 432 (Baxt); Buckley, RP, *Unconscionability amok, or two readily*

distinguishable cases? (1998) 26 ABLR 323.

23. For the potential application of sec 51AB to the principle of good faith in insurance contracts, see ¶17-310.

24. By the *Financial Sector Reform (Consequential Amendments) Act 1998* (Cth), in force 1 July 1998. TPA sec 51AA is re-enacted as *Australian Securities and Investments Commission Act 1989* (Cth) sec 12CA; TPA sec 51AB is re-enacted as sec 12CB. TPA sec 51AAB, in force 1 July 1998, confirms that Pt IVA does not apply to financial services.

¶5-756 Unconscionable conduct in business transactions.

Section 51AC of the *Trade Practices Act*²⁵ mirrors the rights available to consumers under sec 51AB (¶5-755) by providing that a corporation or a person must not engage in conduct that is unconscionable to a “business consumer”. A “business consumer” includes a company (but not a publicly-listed company). Section 51AC is limited to business transactions which do not exceed \$3m (sec 51AC(7)).²⁶ Unconscionable conduct under sec 51AC includes disputes between landlord and tenant, especially involving commercial leases in shopping plazas,²⁷ and disputes between franchisor and franchisee.²⁸

Section 51AC(3) sets out a checklist to help a court determine whether conduct is unconscionable. Section 51AC(3)(a)-(e) is almost identical to the checklist in sec 51AB(2)(a)-(e) dealing with unconscionable conduct to consumers (¶5-755). In addition, sec 51AC(3) adds extra tests of unconscionability relevant to small business to which a court may have regard:

- the extent to which the supplier’s conduct towards the business consumer was consistent with the supplier’s conduct towards like business consumers in similar transactions (sec 51AC(3)(f));
- the requirements of any industry code (sec 51AC(3)(g), (h): ¶7-500);
- non-disclosure by the supplier of any intended conduct that might affect the interests of the business consumer and the risks to the business consumer of this conduct (sec 51AC(3)(i));
- the extent to which the supplier was willing to negotiate the terms and conditions with the business consumer — were standard form contracts (¶5-780—¶5-790) appropriate in the circumstances? (sec 51AC(3)(j)); and
- the extent to which the supplier and the business consumer acted in good faith (sec 51AC(3)(k)).

Section 51AC purposely uses the expression “unconscionable conduct” rather than “unfair conduct” so as to build on existing case law (¶5-730).

The remedies for unconscionable conduct in business transactions in breach of sec 51AC are wider than those for breach of sec 51AA and 51AB, and include an injunction (sec 80: ¶8-810); damages (sec 82: ¶8-840) and an order to rewrite a contract (sec 87: ¶8-860).

It seems that sec 51AC may now be raised in virtually any commercial dispute, and it may prove to be “just as much an unwarranted protection to unworthy litigants as protection to the disadvantaged worthy ... One can

25. In force 1 July 1998.

26. The previous maximum of \$1m was raised to \$3m as from 1 July 2000, to give small business a “fairer go in the marketplace”: Minister for Financial Services and Regulation, Press Release FSR/028, 22 June 2000.

27. eg *ACCC v Leelee Pty Ltd* (2000) ATPR ¶41-742.

28. eg *ACCC v Simply No-Knead (Franchising) Pty Ltd* (2000) ATPR ¶41-744; ¶9-986.

foresee a mushrooming of circumstances in which suppliers will require business consumers to obtain certificates of independent advice.”²⁹

¶5-760 Unconscionability legislation: State and Territory provisions. The provisions of Part IVA of the *Trade Practices Act 1974* (Cth) (¶5-755) are mirrored in State/Territory legislation contained in the Fair Trading Acts (¶7-230).³⁰

New South Wales has further legislation dealing with unconscionable contracts — the *Contracts Review Act 1980*, based on the late Professor John Peden’s *Report to the Minister for Consumer Affairs* in 1976. The Act entitles the courts to re-open and review any type of contract alleged to be harsh and unconscionable. To avoid introducing uncertainty into the law of contract, however, the scope of the Act is limited in two ways:

- (1) No remedy shall be available to public corporations and/or to the Crown (ie government departments). In other words, all “big business” contracts are excluded.
- (2) A list of factors similar to those in the *Trade Practices Act 1974* (Cth) is set out to help the courts decide whether or not a transaction is unconscionable.³¹

— *Case example* —

P worked as a price checker in a supermarket and had had some experience in business. Against the cautionary and informal advice of both her son (an accountant) and a barrister friend, she mortgaged her home for \$68,000 as security for a loan from D Finance Company to inject finance into a struggling business which employed her husband (\$29,000), and to refinance both her existing mortgage of \$30,000 (which was four years in arrears) and an existing loan of \$9,000 by one of the directors of the business. The business did not succeed and the new mortgage fell into arrears. When D attempted to enforce the mortgage and the accompanying deed of loan and personal guarantee (¶13-360) against P, P was unsuccessful in her application

29. Pengilley, W, *An outline of the Trade Practices Amendment (Fair Trading) Bill 1997 and other proposed federal consumer and small business policy initiatives*, CCH Australian Trade Practices Reporter ¶30-934; see also ¶20-770; ¶20-950; *Prohibiting unconscionable conduct within business transactions* (1998) 72 ALJ 93; Baxt, R, *David (and the ACCC) v Goliath*, Charter, Vol 70, No 5, p 64 (June 1999); Duncan, WD and Christensen, S, *Section 51AC of the Trade Practices Act 1974: an “exocet” in retail leasing* (1999) 27 ABLR 280.

30. *Fair Trading Act 1999* (Vic) sec 7-8; 1987 (NSW) sec 43; 1987 (SA) sec 57; 1987 (WA) sec 11; 1989 (Qld) sec 39; 1990

(Tas) sec 15 (amendments recommended by Law Reform Commissioner of Tasmania, *Report on Harsh and Unconscionable Contracts*, Report No 71, Hobart, 1994); 1992 (ACT) sec 13; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 43.

31. Appellate cases reported under the Act, noted (1989) 63 ALJ 495, reflect “the growing trend ... for parties to conveyancing disputes to seek relief under the terms of beneficial modern legislation (including, of course, the *Trade Practices Act 1974* (Cth)) rather than under the traditional doctrines of common law and equity” (p 495).

to have the transaction varied under the *Contracts Review Act 1980* (NSW) for being "unjust". The court, by a majority of 2:1 held that P, able to protect her own interests and with independent advice (which she had rejected), had freely entered a transaction which contained nothing harsh, oppressive, unconscionable or unjust.

McHugh J, giving the leading judgment in this case, raised but did not decide hypothetical questions of whether a contract is unjust if the lender:

- does not insist that the borrower obtain independent legal advice;
- does not ensure that the borrower uses the funds wisely; and
- does not ensure that the borrower is able to repay the instalments.

Kirby J (in the minority) ordered variation of the \$68,000 mortgage by reduction to the \$30,000 for the refinancing of P's existing mortgage. He found the following to be unjust:

- Instead of a loan to the company guaranteed by P and the directors, the loan was "a conscious and calculated distortion of the true nature of the transaction between the parties" which converted the position of P from that of a guarantor of a loan to the company into the borrower herself.
- D knew that P's mortgagee was pressing for payment of its mortgage, that P did not have a solicitor, that the company was virtually insolvent at the time of the negotiations and was incurring further losses and that P had no income to service the loan other than the mortgage payments promised by the guarantor directors.
- P was ignorant of the negotiations, which were done by one of the company's directors with no involvement by P. The director knew that, even with this injection of funds, the company would still not be able to pay its existing debts.
- P obtained no benefit from the \$68,000 transaction other than refinancing the mortgage over her home for \$30,000 and employment benefit for her husband.
- In spite of all this, lender D had not insisted that P obtain independent legal or other expert advice.

*West v AGC (Advances) Ltd*³² —

If P were a married woman who had signed a loan, guarantee or mortgage over the jointly owned family home at the request of her husband, she might be able to claim unconscionability in her own right. The trend is to require evidence that a wife has been advised of the extent of her potential liability

32. (1986) 5 NSWLR 610, noted (1987) 61 ALJ 426. The unconscionability cases involving guarantees and mortgages by a subservient wife for a dominant husband, and elderly parents for ambitious or

unscrupulous children, were inapplicable in a dispute between experienced property developers in *Bosnjak v Farrow Mortgage Services Pty Ltd (in liq)* (1993) ASC ¶56-225.

if there is default by her husband on a loan made in joint names.³³ Where a husband and wife, who are co-guarantors of their company's loan, wish to raise defences including unconscionability, each should be given the opportunity to raise separate defences if their positions are severable.³⁴

In addition, finance industry legislation in all jurisdictions — dealing with moneylending, hire-purchase, consumer credit³⁵ and even takeovers³⁶ — gives the court power to reopen transactions alleged to be harsh and unconscionable.

¶5-780 Standard form contracts. The discussion so far on the creation and contents of a contract suggests that a contract is freely negotiated between parties of equal standing and ability, and that an agreement is arrived at which is to the satisfaction of the parties to the contract. It is true that in many instances agreements are made like this: if you pay me \$5,000, I will sell you this car. But the agreement I entered with the classified column of the newspaper where I advertised the car is not quite so simple. Nor was the agreement under which I originally purchased the car: it contained two pages of fine print, the terms of which I agreed to with the presence of my signature under a line such as "This order is constituted by my signature below and I agree to be bound hereby". On the reverse of the motor car retail contract were 21 clauses, none of which I had read beyond a quick glance. After all, with the chance of losing a good buy if one asks for time to think it over, one has to be fast or the car may be sold to someone else. But the law says that I am bound by what I sign (¶6-190). The fact that I have not read the document is, in law, of no relevance.

In day to day life, a person enters dozens of contracts, most of which are contained in printed standard forms. Standard forms cover such aspects of daily life as insurance policies, bank and credit card accounts, leases, mortgages, car purchases, contracts constituted by bus, train and theatre tickets, lottery entries, building contracts, and contracts of employment ... to name but a few. The document is presented on a take it or leave it basis and negotiation is or can be little more than agreeing to sign or not to sign.

¶5-790 Standard form contracts: current law. The law relating to standard forms as it currently stands was summarised by HB Sales as follows:³⁷

"1. A person who accepted an offer which is based on standard conditions,

33. eg Case note, *Should banks lend to married women?* (1994) 68 ALJ 151; Birman, P, *Provision of security by wives — what she doesn't know may hurt the lender* (1995) 69 LIJ 675.

34. *Morris v Wardley Australia Property Management Ltd* (1994) ASC ¶56-268.

35. For details of the legislation and case law, see ¶14-240.

36. Corporations Law sec 1325C, headed "unfair or unconscionable agreements, payments or benefits".

37. Quoted from Sales, HB, *Standard form contracts* (1953) 16 MLR 318 at pp 319-321.

the terms of which were all specifically brought to his notice, is bound by these conditions, even if he expressed his objections to them.^[38]

2. If a person accepted an offer made subject to standard conditions, but was unaware of their contents, the first question to ask is whether he signed the form containing the conditions or not:—
 - (I) If he signed the form he would be bound by the conditions,^[39] even if he did not know the language in which they were printed.^[40]
 - (II) If he did not sign the form the second question to ask is whether he knew of the existence of the conditions:
 - (i) If he knew of the existence of the conditions he will be bound by them.^[41]
 - (ii) If he was ignorant of the existence of the conditions the third question to ask is whether some, though not necessarily adequate, notice of the existence of the conditions was given:
 - (a) If no notice of the existence of the conditions was given he will not be bound by them.^[42]
 - (b) If notice of the existence of the conditions was given, the fourth question to ask is whether or not the document in which they were contained or referred to was a 'common form' document.^[43]
 - (A) If the document was a 'common form' document he will be bound by the conditions set out or referred to in it.^[44]
 - (B) If the document was not a 'common form' document, the fifth question to ask is whether he knew there was writing on the document:

38. *Walker v York and North Midland Ry* (1853) 2 E & B 750; *Eric Gnapp Ltd v Petroleum Board* [1919] 1 All ER 930.

39. Lord Cairns in *Henderson v Stevenson* (1875) LR 2 HL (Sc) 470 at p 474; Mellish LJ in *Parker v SE Ry* (1887) 2 CPD 416 at p 421; Atkin J in *Roe v Naylor* [1917] 1 KB 713 at p 716; and Lord Haldane in *Hood v Anchor Line* [1918] AC 837 at p 845.

40. *Canadian Pacific Ry v Parent* (1917) 116 LT 165, and *The Luna and The Kingston* (1919) 36 TLR 112.

41. *Parker v South Eastern Ry* (1877) 2 CPD 416, per Mellish LJ at p 421; *Harris v Great Western Ry* (1876) 1 QBD 515. See particularly the judgment of Blackburn J at p 532. Similarly, Lord Haldane in *Hood v Anchor Line* [1918] AC 837.

42. *Henderson v Stevenson* (1875) LR 2 HL (Sc) 470, per Lord Cairns LC at p 476; *Wells v Centaur Co Ltd* (1922) 126 LT 242; *Fosbrooke-Hobbes v Airworks Ltd* (1936) 53 TLR 254; *Chapelton v Barry UDC* [1910] 1 KB 532; *Olley v Marlborough Court Ltd* [1949] 1 All ER 127 at p 134.

43. *Watkins v Rymill* (1883) 10 QBD 178, in which Stephen J first drew the distinction between common form documents and others, although Mellish LJ in *Parker v South Eastern Ry* (1877) 2 CPD 416 at p 422 had also drawn a similar distinction without using the words "common form".

44. *Watkins v Rymill*, *supra*.

- (a) If he did not know that there was writing on the document he will not be bound by the conditions.^[45]
- (b) If he did know that there was writing on the document, the sixth question to ask is whether the notice given to him of the existence of conditions was reasonable notice.
 - (aa) If it was, he will be bound.
 - (bb) If it was not, he will not be bound.^[46]

As Sales noted, this tabulation offers only three chances of escape — those at (a), (a) and (bb) — but the law contained in the exclusion clause/ticket cases indicates that a person may be bound by the ticket (train, bus, airline) as issued. (See ¶16-180ff.)

Issued as they are on a “take it or leave it basis”, standard form contracts are criticised because:

- (1) at the time of the negotiation there was no time to read or understand the fine print, and
- (2) the terms are not open to negotiation.

However, in answer to these criticisms, standard form contracts do have the advantage of reducing transaction costs.

¶5-810 Comprehensibility of legal writing. Even if the terms are read, they may not be understood. A survey entitled *Legal documents: can anyone understand them?*⁴⁷ published its findings on the application to various legal documents of the Flesch Reading Ease Index.⁴⁸ This index is a tool to measure “readability”, ie how accessible or inaccessible a passage of prose is to a reader. It also indicates the level of skills needed by a reader to understand a particular passage.

Flesch took measurements of average word and sentence length to yield a reading ease score which ranged from 0 (most difficult) to 100 (least difficult). Average legal documents, such as an ordinary default summons, were scoring 40-50, while legislation was only scoring 0-10 and was ranked either extremely difficult or almost incomprehensible.⁴⁹

45. *Parker v South Eastern Ry*, *supra*. The opinion here expressed by Mellish LJ as to what was the proper direction to give to the jury was approved by the House of Lords in *Richardson v Rowntree* [1894] AC 217.

46. *Richardson v Rowntree*, *supra*. The questions put to the jury in the court of first instance in this case were slightly different from those designed by Mellish

LJ in *Parker v South Eastern Ry*, *supra*, and more simple. They are substantially those at (B), (II) and (b) in that order.

47. By Lyons, G and Tanner, J (1977) 2 Legal SB 283.

48. As developed by Rudolf Flesch in *The Art of Readable Writing*, New York, Collier, 25th ed, 1972.

49. Lyons and Tanner, *op cit*, p 286.

This means that members of the public may be denied access to the law by the way in which it is expressed — and to the practical matters stated in, for example, a Small Claims Tribunal's pamphlet (score 50-60: fairly difficult) or an old-style insurance policy (score 10: extremely difficult) (but see also ¶17-610 on the move towards "plain English" policies).⁵⁰

LEGALITY OF OBJECTS

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¶5-820 Illegal and void contracts. Freedom to contract is restricted by community values reflected in statutes, and in case law (ie common law). Some statutes make contracts illegal if they involve illegal conduct (¶5-825), while other statutes make them void (¶5-827): "The terms of the statute must be examined carefully to see what consequences flow".⁵¹ Case law makes some contracts illegal at common law (¶5-830) or void at common law (¶5-835).

¶5-825 Contracts illegal by statute. Some contracts are made illegal and therefore unlawful by statute. The statute may state clearly: "A person must not ...",⁵² "A corporation shall not ...",⁵³ and so on. Often the statute does not say whether or not an infringing contract is valid between the parties, and often a contract entered into in breach of statute may still

50. See further, eg, Butt, P, *Plain language in property law: uses and abuses* (1999) 73 ALJ 807.

51. *Allan Rowlands Holdings Pty Ltd v Gaye (No 1) Pty Ltd* (1992) 78 LGERA 38, per Asche CJ at p 47.

52. eg Corporations Law sec 780, 781.

53. eg *Trade Practices Act 1974* (Cth) sec 53 (¶7-290—¶7-370).

operate between the parties — subject to the statutory penalty — even if illegal by statute.

The consequence of statutory illegality is that a statute may make a contract either “illegal as formed” or “illegal as performed”:

(1) *Illegal as formed*. If illegal as formed, the contract is illegal because it is expressly forbidden by statute. It should never have been formed, and it is therefore unenforceable. For example, licensing statutes require some credit providers to be licensed (§14-270).

— *Case examples* —

A stockbroking firm was held to be unable to recover remuneration under its contract with its client for advice in relation to a scheme for the purchase of shares in a company. The scheme involved a breach of the predecessor to the Corporations Law sec 998 (false trading and market rigging) and was therefore illegal.

— *North v Marra Developments Ltd*⁵⁴ —

A contract of sale, transfer of land, mortgage and guarantee in breach of the Corporations Law were illegal and unenforceable. Re-transfer, restitution (§6-510) and damages were ordered.

— *Amadio Pty Ltd v Henderson*⁵⁵ —

Because a contract illegal as formed is expressly forbidden, it cannot be enforced. No one can sue on it, and money paid or property transferred under the void contract cannot be recovered if the claim depends on enforcing the illegality. Later transactions based on the illegal transaction are also void. Instead, action may be taken for restitution (§6-510).

(2) *Illegal as performed*. Even if a contract is legal as formed, it may be illegal if performed in an illegal way or for an illegal purpose.

Incidental illegality. If innocent conduct is incidental to the performance of the illegal contract, its “incidental illegality” will not necessarily make it illegal and unenforceable. Amounts owing by the innocent party still have to be paid, and the innocent party can enforce the contract in the normal manner. Otherwise, the guilty party would obtain a windfall gain which would be “unmerited and ... an affront to the public conscience ... the rule of public policy ... is [not] as inflexible and harsh as to produce such an offensive result.”⁵⁶

— *Examples of incidental illegality* —

- Five passengers in a taxi licensed to carry four passengers still have to pay the taxi fare, although the driver may be prosecuted by traffic authorities.

54. (1981) 148 CLR 42.

55. (1998) 81 FCR 149 (breach of the prescribed interest provisions).

56. *Fitzgerald v FJ Leonhardt Pty Ltd* (1997) 71 ALJR 653, per Kirby J at p 674.

- Goods supplied under a contract in breach of the *Trade Practices Act 1974* (Cth) (say for price fixing: ¶8-110) still have to be paid for. The buyer still has remedies under the Act, for example for breach of its implied terms (¶7-035ff).
- A shipowner overloading a ship in breach of statute, and therefore liable to a penalty under the statute, was entitled to payment for freight, because the object of the statute was not to prohibit contracts but to prevent overloading.⁵⁷
- Although a loan advanced by a lender secured by mortgage was held to breach the *Banking Act 1959* (Cth) because the lender was carrying on banking business without a licence, and was likely to expose the lender to a penalty, the loan contract was still held enforceable.⁵⁸
- Running and managing a brothel is illegal under the laws of the ACT. The employment contract of a receptionist in a brothel, while a criminal offence under the legislation, is not void or unenforceable, and the receptionist is a “worker” for the purposes of claiming workers’ compensation for slipping and breaking her arm while at work.⁵⁹
- A builder who carried out building work was liable for damages for breach of contract caused by his defective workmanship, even though he was not registered as required by the legislation and the work was carried out in breach of the Act.⁶⁰
- A purchaser of a house makes a false declaration in a finance application in breach of legislation. The seller cannot refuse to complete the sale if it learns of the false declaration. “There is nothing ‘illegal’ in the transaction between the parties.”⁶¹
- A landowner in the Northern Territory contracted with a licensed driller to drill bores for water. The landowner, who did not obtain the necessary drilling licence as required by legislation and who could be prosecuted by the water authority, could not refuse to pay the driller on the basis that the contract was illegal under statute. The contract was enforceable against the landowner.⁶²
- An insurance contract arranged by an unregistered insurance broker is still valid — to decide otherwise would penalise the innocent insured for a statutory breach by its representative.⁶³

Conduct found misleading or deceptive under sec 52 of the *Trade Practices Act 1974* (Cth) (¶7-250ff) is governed by the various remedies of that Act such as injunctions, corrective advertising and in particular the power

57. *St John Shipping Corporation v Joseph Rank Ltd* [1957] 1 QB 267; [1956] 3 All ER 683.

58. *Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd* (1978) 139 CLR 410; (1978) 53 ALJR 1; noted at (1979) 53 ALJ 582.

59. *Barac (t/as Exotic Studios) v Farnell* (1994) 125 ALR 241.

60. *Gaffney v Ryan* [1995] 1 Qd R 19.

61. *Nelson v Nelson* (1995) 184 CLR 538, per Toohey J at p 594; ¶9-755.

62. *Fitzgerald v FJ Leonhardt Pty Ltd* (1997) 71 ALJR 653.

63. *Insurance (Agents and Brokers) Act 1984* (Cth) sec 19; ¶17-590.

of the court to rewrite contracts under sec 87 (§8-860), instead of by “the blunt bludgeon of illegality”.⁶⁴ A public policy of illegality cannot be read into sec 52.

¶5-827 Contracts void by statute. Some contracts are not illegal but are made void⁶⁵ or of no legal effect by statute. This means that the void contract will not be enforced by the courts, and it creates no legally enforceable rights between the parties to the contract.

For example, a term in a contract that purports to exclude the implied terms of the *Trade Practices Act 1974* (Cth) is void under sec 68 (§7-170). A real estate contract to sell land which had been subdivided without approval was declared void and of no effect.⁶⁶ Many contracts with minors are void (§5-520ff). Certain gaming and wagering contracts are void, and if the loser fails to pay, the courts will not enforce the contract. A service station franchise agreement purporting to exclude or evade petrol marketing franchise legislation is void.⁶⁷ The Consumer Credit legislation outlined in Chapter 14 declares many moneylending practices void.

Some contracts may be void only as against certain persons. For example, certain dealings by an insolvent person are valid except in so far as they are “void against the trustee” in the bankruptcy of the insolvent person (*Bankruptcy Act 1966* (Cth) sec 120-122: §13-670—§13-690).

Amounts paid under a void contract may be recoverable in restitution (§6-510) if recovery is not possible under the legislation which has rendered the payment void.

¶5-830 Contracts illegal at common law. A number of contracts harmful to society are discouraged by the law and are made illegal. Some are also criminal and are subject to criminal penalties:

(1) *Contracts which involve the commission of a crime or a tort or a fraud on a third party.* If there is an agreement between A and B to procure a breach of contract between B and C in order to allow B to contract with A, the agreement between A and B is illegal.

— *Case example* —

Major Rowlandson had insured his life for £50,000. His finances were in disarray with some £60,000 owing to creditors. Three minutes before the policy was due to expire, he shot himself to enable his creditors to receive the benefit of the policies which were his only assets. Because suicide was a criminal offence, it was held that his executors could not recover on the policies because “the court will not enforce [a policy] if it is illegal, or

64. *Bank of America Australia Ltd v Ceda Jon International Pty Ltd* (1989) 17 NSWLR 290 at p 295, noted (1990) 64 ALJ 369.

65. ie void “ab initio”.

66. *Allan Rowlands Holdings Pty Ltd v Gaye (No 1) Pty Ltd* (1992) 78 LGERA 38.

67. *Caltex Oil (Australia) Pty Ltd v Best* (1990) 170 CLR 516; (1990) 65 ALJR 64, noted (1991) 65 ALJ 246.

contrary to public policy, or if it is otherwise such an agreement as the court in its inherent jurisdiction will refuse to enforce”.

— *Beresford v Royal Insurance Co Ltd*¹ —

Other examples of such conduct would be contracts to provide for the payment of a secret commission, and contracts between a debtor and creditor to the prejudice of the guarantor/surety. A contract entered into by an infertile couple and a surrogate mother may involve the commission of a crime (breach of legislation such as that regulating the adoption of children, conspiracy) and may therefore be illegal.² Such a contract may also fall into the following category.

(2) *Contracts which are sexually immoral.* Contracts knowingly made for an immoral purpose, such as a prostitute's hire-purchase contract with a coach builder in the 1860s for a specially designed carriage, cannot be enforced.³

— *Case example* —

A landlord leased a house to a tenant whom he knew to have a lover. The landlord also knew that the lover visited his mistress (the tenant) at the rented premises to, in the words of the judge (in 1911), “commit fornication” there. When the landlord sued the tenant for rental arrears, she successfully raised the rule against him that he could not sue upon the lease because it was a contract for an immoral purpose.

— *Upfill v Wright*⁴ —

This case is now obsolete, as current attitudes to *de facto*⁵ and other personal relationships are such that the parties are generally free to sue on contracts made between them with respect to property rights: “The social judgments of today upon matters of ‘immorality’ are as different as is the bikini from the bustle.”⁶

(3) *Contracts which prejudice the due administration of justice*, such as contracts stifling a prosecution for a criminal offence, contracts not to reveal

1. [1938] AC 586; [1938] 2 All ER 602. The effect of this decision may be affected by the *Life Insurance Act 1995* (Cth) sec 228; ¶17-790.

2. cf *The Baby M case and surrogate motherhood* (1987) 61 ALJ 322 (US court upholding legal validity of surrogacy contract); surrogacy contracts to be permitted under strict controls: Hunt, B, *Surrogacy banned* (1991) 62 Reform 113.

3. *Pearce v Brooks* (1866) LR 1 Exch 213.

4. [1911] 1 KB 506.

5. eg *Property (Relationships) Act 1984* (NSW); *De Facto Relationships Act 1986*

(Vic); *Property Law Act 1958* (Vic) Pt 9; *Domestic Relationships Act 1994* (ACT); *De Facto Relationships Act 1991* (NT); discussed Bailey-Harris, R, *De facto relationships: searching for justice nationwide*, Reform, Vol 66, p 27 (1993). These Acts amongst other things enable *de facto* couples to enter “cohabitation agreements” or “separation agreements” subject to and enforceable in accordance with the law of contract; the law of trusts is also important in determining property ownership: ¶9-755.

6. *Andrews v Parker* [1973] Qd R 93, per Stable J at p 104.

information that would assist in the investigation of a crime, and contracts of maintenance and champerty.⁷

(4) *Contracts which promote corruption in public life*, such as contracts for the sale of public offices,⁸ lobbying contracts and contracts to bribe a public official.

(5) *Contracts which defraud/deceive public authorities (including taxation authorities)*, such as attempts to defraud federal or State authorities in respect of income tax, land tax or other rating or taxing liability. Such agreements, usually made at the request of one party and frequently known to the other party, are unenforceable by either party. For example, a contract to sell a home unit within 12 months of purchase which also provided for a second contract of sale at a later date designed to avoid former sec 26AAA (repealed 1994) of the *Income Tax Assessment Act 1936* (Cth) was held void for illegality, and the vendor's claim to the purchaser's deposit and damages was therefore unenforceable.⁹

(6) *Contracts which prejudice the safety of the state*. Trading contracts with an enemy alien made in time of war could obviously not stand. Outbreak of war can frustrate performance of a contract: ¶6-350.

(7) *Contracts to carry on acts which are illegal under the law of a foreign and friendly state*. Contracts to supply alcohol to prohibition America¹⁰ or to bypass a national blockade of trade with South Africa over its apartheid policy¹¹ have been held to fail as a matter of public policy.

¶5-835 Contracts void at common law. Some contracts are unenforceable as a matter of public policy:

"The refusal of the courts to enforce contracts on grounds of public policy is a striking illustration of the subordination of private right to public interest. The problem is one of formulating with any degree of precision the criteria or the circumstances which will justify a court in refusing to enforce a contract on the ground that there is a countervailing public interest amounting to public policy."¹²

Three types of contract are void at common law on the grounds of public policy:

7. Maintenance is the supporting of litigation by a third person without lawful cause. Champerty is a form of maintenance of litigation in consideration of a promise to give the maintainer a share of the proceeds.

8. eg *Garforth v Fearon* (1787) 1 Hy Bl 328; 126 ER 193.

9. *Effie Holdings Properties Pty Ltd v 3A International Pty Ltd* (1984) NSW ConvR ¶55-174; cf *Gray v Pastorelli* [1987] WAR 174, noted (1986) 60 ALJ

637 (intention to defraud Commonwealth of tax revenue not carried out).

10. *Foster v Driscoll* [1929] 1 KB 470.

11. *Regazzoni v KC Sethia (1944) Ltd* [1958] AC 301; [1957] 3 All ER 286.

12. *A v Hayden* (1984) 156 CLR 532 at p 559. Public policy is generally not available for relief from the obligation to pay debts: *Edgeley Mutual & General Investment Services Pty Ltd v Eeklo Pty Ltd* (1988) 6 ACLC 397.

(1) *Contracts to oust the jurisdiction of the courts.* Parties to a contract cannot include a clause preventing recourse to a court of law in the event of a dispute on the grounds of public policy. After all, the courts are open to all comers. It is common to find an arbitration clause in some contracts such as insurance policies and building contracts whereby arbitration before a specialist tribunal is agreed to rather than litigation in a court. This is acceptable as long as the right of appeal, or the right of parties to state a case for the opinion of the court, is allowed. If not, the clause would fail for breach of public policy.¹³

(2) *Contracts which prejudice the status of marriage.* There are a number of different types of contract surrounding the marriage relationship: a promise of marriage is enforceable; an undertaking not to marry a person of a certain faith is enforceable if reasonable; but a marriage brokerage contract is unenforceable.

(3) *Contracts in restraint of trade.* These are discussed at ¶5-840—¶5-870.

¶5-840 Contracts void at common law: contracts in restraint of trade.

In many situations recognised by law, people come up against contracts limiting their trade or business. The law recognises a person's right to carry on any chosen trade or business so long as nothing unlawful is done. A contract in restraint of trade (namely a contract in which one party — the covenantor — agrees with the other party — the cantee — to restrict future freedom to carry on trade in any chosen manner with other persons who are not parties to the contract)¹⁴ will be prima facie unenforceable unless it is reasonable by reference to the interests of the parties and of the public.

A legitimate interest, object or aim capable of being protected by a covenant in restraint of trade includes "a petrol company's 'interest' in a stable system of outlets to the public, and the health of the petrol, football and other sporting industries and of the retail chemist trade. There has even been recognition that a cantee has an interest meriting protection in securing and retaining customers by sole supply contracts."¹⁵ A legitimate interest may be proprietary or commercial.

Unless the unreasonable part can be severed or deleted (¶5-885—¶5-887), the whole contract will be unenforceable. Because of this possibility, legal drafting practice is to frame restraint clauses as a "ladder clause" by way of alternative areas of restrictions on a decreasing scale relating to type of business activity, time and geographic area.¹⁶

13. *Scott v Avery* (1856) 5 HL Cas 811; 10 ER 1121; ¶1-443.

14. *Petrofina (Great Britain) Ltd v Martin* [1966] Ch 146 at p 180. See further CCH *Australian Trade Practices Reporter*, ¶3-100ff.

15. Heydon, JD, *The Restraint of Trade Doctrine*, London, Butterworths, 2nd ed,

1999, proof pages of which were cited in *Stokely-Van Camp Inc v New Generation Beverages Pty Ltd* (1998) ATPR ¶41-657 at p 41,294.

16. eg Costello, K, *Variable restraints of trade — the efficacy of "ladder" clauses* (1991) 13 LSB 10.

Contracts in restraint of trade are not illegal, but they are unenforceable at common law. They may also be affected by the *Trade Practices Act 1974* (Cth) (§8-050). However, because the Act does not apply in all situations, due to constitutional limitations (§7-220), and because its provisions coexist with the common law doctrine of restraint of trade, the following propositions summarising the law on restraint of trade at common law remain important:¹⁷

- “(1) Freedom of trade cannot, without sufficient legal justification, be restricted by agreement simply on the principle of freedom of contract. ...
- (2) No person has an abstract right to be protected against competition per se in his trade or business. ...
- (3) If there is something which he is entitled to be protected against, then a reasonable protection for that purpose contracted for will be upheld as far as the personal interests of the parties themselves are concerned, and subject to public interests. ...
- (4) Reasonableness is a question of law to be determined by the Court on the special circumstances of the case. ...
- (5) The onus of proving the special circumstances justifying the restriction as reasonable between the parties lies on the person alleging it to be so; the onus of proving injury to the public is on the person alleging it. ...
- (6) When a man sells anything he may preclude himself from lessening by competition the value of what he sells, provided the restriction is not unreasonable, having regard to the subject matter of the contract. ...
- (7) Therefore, when the goodwill of a business is sold, a reasonable covenant on the part of the vendor against competition is valid in order to protect what is bought and sold. ...
- (8) But the business the goodwill of which is to be protected is a specific business, transferred by the covenantor to the canteee. ...
- (9) Similarly, if what are properly called ‘trade secrets’ are sold, they are regarded as property, and may be similarly protected. ...
- (10) But general skill and knowledge which a person of ability necessarily acquires in his business or calling is not a trade secret, and is not knowledge which can be regarded as property.”

The following situations (§5-850—§5-870) are well documented examples, but, as once remarked, “[t]he categories of restraint of trade are not closed. As methods of trading change, so do the areas of restraint. The law, if it is to fulfil its purposes must keep pace with them.”¹⁸ The categories of restraint are capable of expanding as and when needed. The cases embody restraints imposed by professional associations, partnership deeds, the use of a trade

17. *Bacchus Marsh Concentrated Milk Co Ltd v Joseph Nathan & Co Ltd* (1919) 26 CLR 410, per Isaacs J at pp 440-441.

18. *Petrofina (Great Britain) Ltd v Martin* [1966] Ch 146 at p 169.

name, agreements by tradesmen to work for one person only, agreements by manufacturers to make one product only, or to sell to one person only.

¶5-850 Restraint of trade: (1) agreements between employer and employee. Employees often have access to trade secrets, confidential information (¶3-685), business contacts, mailing lists, etc and may be able to poach clients of their employer, especially on leaving that employment. General skills and technical knowledge acquired in the course of employment are not relevant in this context. To protect employers' legitimate interests, employment contracts often limit, by means of a restraint of trade clause, competition from an employee: "an employer with a relevant protectable interest can restrain an employee from accepting a position the nature of which is such that the employee would be likely to utilise confidential information or trade connections which have been acquired in the course of employment".¹⁹

The courts will provide protection to the employer under a restraint of trade clause if that would be both reasonable between the parties and reasonable in the public interest. But this has to be balanced with the legitimate rights of employees to practise their trade or profession and to sell their expertise.

— *Case examples* —

Rugby league transfer system (1960s). Rugby league's earlier transfer system effectively tied a player to a league club, even if the player was not contracted to play with the club. If a player was on a transfer list, any other club wanting him had to pay to his club a transfer fee (set by the club) of which the player received only a small percentage. These transfer rules were struck down by the High Court as being in restraint of trade and unjustified in two respects: (1) they prevented a player from transferring to another club even after he had ceased to play for the club that retained him; and (2) the transfer fee system had no rules and was unduly restrictive on players.

— *Buckley v Tutty*²⁰ —

By agreeing with the South African Cricket Union to take part in cricket tours in South Africa in 1985/86 and 1986/87 in breach of international agreements prohibiting sporting contact with South Africa, former Australian cricket test captain Kim Hughes was barred by a change in the rules of the Cricket Council of the Western Australian Cricket Association (Inc) (the WACA) from playing local district cricket and, effectively, interstate Sheffield Shield and international Test cricket. Action to challenge the WACA's decision was taken on several legal grounds including the *Trade Practices*

19. *Rentokil Pty Ltd v Lee* (1996) ATPR ¶41-451 (Full Court, SA) per Doyle CJ (employer/employee restraint upheld). See also *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688; *Lindner v Murdock's Garage* (1950) 83 CLR 628.

20. (1971) 125 CLR 353; (1972) 46 ALJR 23; see, eg, Pengilly, W, *Sporting drafts and restraint of trade* (1994) 10 QUTLJ 89. See also *A Schroeder Music Publishing Co Ltd v Macanlay* [1974] 1 WLR 1308; ¶5-730.

Act (unsuccessful), tort (interference with entitlement to work held not to constitute a tort), the tort of conspiracy (failed), procedural *ultra vires* (failed), the *Equal Opportunity Act 1984* (WA) (failed), and restraint of trade at common law (successful). *Toohy* J held that the change in the WACA's rules went beyond a restraint reasonably related to the objects of the Cricket Council and those who comprised its membership and was therefore void.

The Federal Court confirmed that restraint of trade extends beyond "trade" as such to persons, such as sports persons who are amateurs and whose other occupations may pay more than their sport, so long as the person whose rights or interests are affected is a professional player. It also extends beyond the need for a legally enforceable employment contract between the parties. Nor need the applicant show that the rules of, in this case, the WACA, constitute a contract between him and the Association, since if they place an unjustifiable restraint on the income earning activities of a person, a court can grant relief here even if that person is not a member of the Association.

_____ *Hughes v Western Australian Cricket Association (Inc)*²¹ _____

Rugby league "internal draft" (1990). One hundred and fifty-four players challenged the New South Wales Rugby League's "internal draft" procedure which was introduced in 1990. The 1990 draft enabled league clubs to choose players from a pool of uncontracted players with priority to be given to less successful clubs. The players' challenge was unsuccessful under the *Trade Practices Act 1974* (Cth) but it was successful under the doctrine of restraint of trade at common law:

(1) *Trade Practices Act*. The applicants' case under sec 45(2) was that there was an agreement or understanding to which the clubs were a party which contained an exclusionary provision prohibited under sec 4D/45(2) (¶8-220). However, because the players were employees of the clubs under contracts of service, they were held to be expressly excluded from sec 45 by the definition of "services" in sec 4 which excludes employees.

(2) Restraint of trade at common law. Although drafted with the best of intentions, supposedly to benefit the league, and adopted unanimously by all clubs, the rules were found to be in restraint of trade at common law as they infringed the freedom and interests (economic and non-economic) of the players. Operating at the end of a player's contract, they imposed a new post-contract restraint, a greater restraint than was necessary for protection of the league and its players.

_____ *Adamson v New South Wales Rugby League Ltd*²² _____

The George Michael case. Singer George Michael failed to gain a declaration that his recording agreement with Sony was void and unenforceable as an unreasonable restraint of trade. Under the agreement, Michael was to provide his exclusive recording services to Sony, was bound to deliver eight albums and was bound to Sony for that time (up to a maximum time of 15 years). For example, there was evidence that the original agreement had been re-negotiated several times, and that Michael had negotiated complete creative

21. (1986) 19 FCR 10; (1986) ATPR ¶40-736, 22. (1991) 31 FCR 242; (1991) ATPR ¶41-141. noted (1987) 61 ALJ 736.

control including delivery of master recordings. In other words, Michael controlled the length of the contract and his case of "professional slavery" failed.

— *Georgios Panayiotou v Sony Music Entertainment (UK) Ltd*²³ —

¶5-860 Restraint of trade: (2) agreements between buyer and seller of a business or between partners. Restrictive clauses appearing in vendor/purchaser sale contracts and partnership agreements (¶10-550) may be inserted to protect the interests of one party from competition from the other. Such competition could destroy the goodwill, contacts and custom purchased under the contract. In this situation, the parties are dealing at a more equal level, and the courts are more prepared to uphold the bargain made.

Labour market controls in professional sport which restrict player mobility such as transfer systems, zoning rules, draft schemes and salary caps to limit payment may be unreasonable restraints of trade.²⁴

The question is what is reasonable to protect the parties, such as the legitimate interests of the sporting clubs, the interests of the buyer of the business or interest, the seller, and the public as a whole.

— *Case examples* —

Thorsten Nordenfelt, the patentee and manufacturer of guns and ammunition, sold his business, which had world-wide connections, to a limited company. At the same time he entered into a restrictive trade covenant with the purchasing company. Some time later, that company sold out to a second company, at which time the original vendor, Nordenfelt, entered into a further restrictive trade covenant, in part narrower and in part wider than the first covenant. Nordenfelt breached the section of the second covenant which prevented him from engaging in business "except on behalf of the company either directly or indirectly in the trade or business of a manufacturer of guns ..." for 25 years or in any other trade or business competing or liable to compete with the company. The company's injunction to enforce the covenant was granted on the basis that, although it was unrestricted as to space, it was not unrestricted with regard to the nature of the business (guns and ammunition) and the limited number of customers (various governments). It was also held to be no wider than was necessary to protect the purchaser, nor was it injurious to the public interest.

— *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd*²⁵ —

23. The Times, 30 June 1994; appeal dismissed, 12 January 1995, English Court of Appeal, unreported, discussed by Charlesworth, B, *George Michael: professional slavery or occupational hazard?* (1994) 68 LJ 1172.

24. eg Buti, A, *Salary caps in professional team sports: an unreasonable restraint of trade* (1999) 14 JCL 130.

25. [1894] AC 535.

The “solus” or “exclusive dealership” agreement which tied a service station owner to Esso for 21 years was held to be unreasonable. A shorter agreement of four years and five months was held to be reasonable.

————— *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd*²⁶ ———

D purchased a share of P's business on entry into partnership as insurance loss adjusters at Mermaid Beach, Queensland. Clause 21 of the partnership agreement provided basically that in the event of dissolution of partnership, D would not carry on business of a similar nature within a radius of 32 km of Mermaid Beach for a period of three years. On dissolution of the partnership by P, and in breach of the agreement, D commenced business 6½ km away at Burleigh Heads. Action by P to enforce the clause was successful on the basis that it provided reasonable protection to P, was limited in space and time and was not contrary to the public interest.

————— *Geraghty v Minter*²⁷ ———

P, the maker of Pauls ice-cream nationally and Peters ice-cream nationally except in Western Australia, sold its Western Australian ice-cream business to D in 1983. Under the agreement, P covenanted not to sell ice-cream in Western Australia, and D was given various options for extension which could extend the term up to 31 years.

P was successful in gaining a court declaration that the restraint was void as being a restraint of trade to which the common law doctrine of unreasonable restraint applied. This was because the restraint:

- was not incidental to the licensing arrangement between P and D (over the name “Pauls”), and extended to any ice-cream of P sold under any name whatsoever;
- did not promote trade but restrained it;
- gave D more protection than D was entitled to;
- was for too long a period. Its initial term was 15 years, and D could not show that a shorter time would not have been adequate; and
- gave D unreasonable protection against competition from P.

Further, the restraint was not reasonable having regard to the public interest, as it prevented consumers in Western Australia from obtaining ice-cream from P for at least 15 years.

26. [1968] AC 269.

27. (1979) 142 CLR 177; (1979) 53 ALJR 638. Similarly, *Sbarah v Healey* [1982] 2 NSWLR 223; noted (1983) 57 ALJ 356. Covenants against competition on termination of a partnership of solicitors were not unreasonable in area (within 10 miles of the Sydney GPO) and duration (three years). Acceptance of restraints

was balanced by the advantages of the partnership: *Brown v Cunich* (1994) ATPR (Digest) ¶46-117; the restraint in *Fisher v GRC Services Pty Ltd (No 1)* (1998) ATPR (Digest) ¶46-180; *(No 2)* (1998) ATPR (Digest) ¶46-181 which prohibited solicitation of clients by a former partner was held not to be an unreasonable restraint of trade.

The restraint was not one of the exceptions to sec 45 or sec 48 of the *Trade Practices Act 1974* (Cth) in sec 51(2)(e): ¶8-020.

_____ *Peters (WA) Ltd v Petersville Ltd*²⁸ _____

¶5-870 Restraint of trade: (3) trading agreements between manufacturers and retailers. An agreement between manufacturers or persons in a particular industry, which regulates that industry and the prices of the products, will be enforceable if it does not impose an unreasonable restraint on (1) the parties themselves and (2) the public.

Exclusive selling agreements, such as one where a dairy farmer was obliged to sell all his milk to an agricultural co-operative (with no power on the part of the farmer to terminate the obligation), have been held to be unreasonable if they impose upon the parties greater restrictions than would reasonably be required for the protection of the co-operative/society/organisation.²⁹ But if the scheme is part of an overall marketing scheme accepted by the majority of producers with no unusual or restrictive features it will be enforceable³⁰ subject to the provisions of the *Trade Practices Act* (see ¶8-050; ¶8-220).

Exclusive purchasing agreements face the same scrutiny. Solus petrol agreements (ie agreements between petrol companies and service stations providing for the sale of one brand only) and tied hotel agreements have provided much of the case law. A four-year-and-five-month tie of a service station to a petrol company was held to be reasonable but a 21-year tie between the same operators contained in a mortgage was held to be unenforceable.³¹ The fact that this case involved a business transaction did not save the latter tie, because no assurance was given by the petrol company to supply petrol at a reasonable price, come what may, in consideration of the solus agreement.

¶5-885 Effects of illegal and void contracts: severance. If part of a transaction is illegal or void by statute (¶5-825—¶5-827) or illegal or void at common law, such as a restraint of trade stipulation (¶5-830—¶5-870), the offending part may be able to be cut or severed so that the remaining part of the transaction can be enforced if:

- (1) it is technically possible to sever it, and

28. [1999] FCA 1245; (1999) ATPR ¶41-714; similarly, *Brendon Pty Ltd v Russell* (1994) ATPR ¶41-340 (sale of scrap metal business).

29. eg *McEllistrim v Ballymacelligot Co-operative Agricultural and Dairy Society Ltd* [1919] AC 548.

30. *English Hop Growers Ltd v Dering* [1928] 2 KB 174.

31. As a clog on the equity of redemption: *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at p 325; [1967] 1 All ER 699. In addition to the common law doctrine of restraint of trade, mortgages come within unconscionability legislation (¶5-755—¶5-760), the *Trade Practices Act 1974* (Cth), and the unconscionability provisions of the consumer credit legislation (¶14-240).

(2) the contract can take effect with that part severed.

If the severance of the invalid parts changes the extent but not the kind of contract, the valid parts are severable.³²

— *Example of severance* —

Vendor sells a business in Sydney which has a local goodwill extending throughout but not appreciably beyond the City of Sydney. The contract of sale contains an undertaking by the vendor not to engage in a competing business:

- (1) in the City of Sydney. This of itself does not offend public policy and is wholly valid.
- (2) in the City of Sydney, nor within the County of Cumberland (the local government area encompassing Sydney and suburbs). This promise is wider than necessary for the protection of the buyer and therefore offends public policy. However, it is treated as being made up of separate promises for each local government area and under the doctrine of severance is held valid for the City of Sydney.
- (3) in the County of Cumberland. As with (2), this is wider than necessary for the protection of the buyer but, because it cannot be verbally dissected as (2) can, it is altogether invalid, and the court would therefore not stop the seller from engaging in a competing business within a few metres of the business just sold.³³

Because the courts will not rewrite contracts entered by the parties in this situation, legal practice is to include several distinct provisions in restraint of trade, set out in a series of diminishing geographic and time restraints, to be read together in different alternative combinations to allow the courts to preserve those considered reasonable. However, this device could fail if there is no evidence as to which covenant is intended to take priority or if the covenants are inconsistent (ie they cannot stand together at the same time). In a case where the restraint included six alternative stipulated periods, six activities in which the vendor was not to engage, 14 products, and 163 possible combinations of areas in which the restriction was to operate or ($6 \times 6 \times 14 \times 163$) 82,152 covenants, there was no evidence of the priority of one variable over any of the others and the covenant was held to be void for uncertainty.³⁴

32. *Humphries v Proprietors "Surfers Palms North" Group Titles Plan 1955* (1994) 179 CLR 597.

33. *Report of the Law Reform Commission on Covenants in Restraint of Trade*, LRC 9, Government Printer, NSW, 1970, para 9.

34. *Austra Tanks Pty Ltd v Running* [1982] 2 NSWLR 840; (1983) ATPR ¶40-340; noted (1983) 57 ALJ 422. Section 4 of the *Restraints of Trade Act 1976* (NSW) (¶5-887) deals with public policy and could not protect this restraint because of its uncertainty.

¶5-887 Severance of partially void restraint of trade stipulations in New South Wales. The law regarding enforcement of promises in restraint of trade in part offensive to public policy was analysed by the New South Wales Law Reform Commission and judged unsatisfactory. State legislation was recommended to avoid the limitations of approach (3) in the Example in ¶5-885 in favour of approach (2) and the dictates of public policy. This report (1970) formed the basis of the *Restraints of Trade Act 1976* (NSW).³⁵

Section 4(1) of the Act provides that: "A restraint of trade is valid to the extent to which it is not against public policy, whether it is in severable terms or not". The Act does not protect a restraint which may be invalid for other reasons such as uncertainty, mistake, fraud or absence of consideration.³⁶

The key section of the Act, sec 4(3), enables any party (buyer, seller, etc) subject to a restraint to apply to the court for an order that the restraint be declared "altogether invalid or valid to such extent only (not exceeding the extent to which the restraint is not against public policy) as the Court thinks fit". Early judicial interpretations limiting the operation of sec 4 — such as that it only empowers the court to strike out words, or that only a person subject to restraint can apply for an order³⁷ — must now be read in the light of expansive case law such as the following:

— *Case example* —

The goodwill of a stock and station agent's business at Berridale, New South Wales was sold by B Ltd (for practical purposes, the defendant John Henry Smith) to Mr and Mrs D Smith in 1980. A term of the contract was that D covenanted for a period of five years not to engage or be interested in, whether as principal or agent, the business of a stock and station agent within a radius of 100 km from the post office at Berridale. In 1982 the Smiths sold the agency to P, and assigned to P the covenant given by D. When D commenced employment in a stock and station agency at Cooma (33 km from Berridale) in 1983, P sought to enforce the covenant to restrain D until the agreed date of 1985. The covenant was upheld as valid, reasonable between the parties and not offensive to public policy.

— *Fleming Bros (Monaro Agencies) Pty Ltd v Smith*³⁸ —

The facts in this case were held not to be in breach of public policy, and the restraint could therefore be upheld by common law principles (¶5-840). However, in passing, the judge cited earlier New South Wales authority that the effect of the *Restraints of Trade Act 1976* (NSW) is to validate a restraint of trade to the extent that it imposes a reasonable restraint. In particular, defining the outer limits of validity of a restraint will depend on the nature and degree of generality of the relief sought, and the court is empowered to remould an offending restraint by introducing new words.

35. *Report of the Law Reform Commission on Covenants in Restraint of Trade*, LRC 9, Government Printer, NSW, 1970, para 9.

36. *Ibid*, para 55.

37. *Beetson v Humphreys* [1980] ACLD 348.

38. (1983) ATPR ¶40-389; similarly, *Clegg v Henwood* (1995) ATPR ¶41-440 (sale of shop); *ICT Pty Ltd v Sea Containers Ltd* (1995) ATPR (Digest) ¶46-145 (NSW Court of Appeal) (sale of ferry).

Chapter 6

Operation of the Contract

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¶6-010 What the parties have agreed to: representations or terms. Chapter 5, which focused on the formation of a contract, set out the law regulating:

- intention to contract: ¶5-050;
- offer and acceptance: ¶5-130;
- consideration or price: ¶5-400;
- capacity to contract: ¶5-510;
- genuine consent including unconscionability: ¶5-610; and
- legality of contracts: ¶5-820.

A valid contract is made when all these requirements are fulfilled.

The contents of the contract are what the parties have agreed. Sometimes it is not clear what the parties have agreed to — some things were said before the contract was made, some things are critical, some are important and some are unimportant.

The law classifies statements made during negotiations into two categories:

- (1) *Representation* — a statement made pre-contract in the course of negotiation, not intended to be legally binding (¶6-020).
- (2) *Term* of the contract, which is legally binding. Two levels:
 - *Condition*, a term of crucial importance to the contract. Breach of condition leaves the innocent party free either to end the contract, or to continue to perform the contract and sue for damages (¶6-050—¶6-090).
 - *Warranty*, a term of lesser importance to the contract. Breach of warranty leaves the contract intact, allowing the innocent party to sue for damages, but the innocent party must still perform the contract (¶6-050; ¶6-090).

The difference between a non-contractual representation and a contractual term depends on the intention of the parties and the importance to the contract.

Whether the representation or term is spoken or written is not necessarily the test. If a contract is wholly oral (spoken), it becomes a question of analysis to work out whether what was said was intended to be acted upon (term) or

whether it was to be only words of encouragement (representation). If the contract is wholly written, the presumption is that what is written contains all the terms of the contract. But where words in the written contract have to be defined or explained, the problem of oral evidence about a written contract arises.

The parol evidence rule (§5-030) states that where a contract is reduced to writing and where the writing appears to contain the whole contract, it is presumed that the writing contains all the terms of the contract and that evidence will not be admitted of any previous or contemporaneous agreement which would have the effect of adding to or varying the agreement. Preliminary agreements, letters of negotiation and the like are not generally admissible for the purpose of adding terms or altering the legal construction of the document, although extrinsic evidence of the surrounding circumstances may be adduced to aid identification. The parol evidence rule means that if a word appearing in writing in a written contract cannot be understood by the parties — or if it is in dispute — evidence cannot be presented to explain its meaning. Note also that some contracts must be wholly in writing by the operation of legislation (see §5-030), in which case oral evidence may also not be admissible.

A contract is not made in a vacuum, but is to be interpreted in the context of the circumstances: “Research in the United States and Great Britain suggests that probably the majority of people in ongoing business relationships regulate their relationships in accordance with what they consider is fair and reasonable or commercially necessary at particular points of time rather than by reference to *a priori* rights and duties arising under a contract ... This is the case even where their relationship is governed by a written contract.”¹

The rules of legal interpretation applying to contracts are set out at §1-500—§1-550 (in the context of interpretation of statutes), and further rules of interpretation of contracts (with the example of insurance contracts) are set out at §17-620.

§6-020 Representations. A representation, non-contractual representation or “mere representation” is a statement of fact, made by a party before or at the time of making a contract, which is addressed to the other party and in fact induces the other party to enter into the contract. Such representations do not form part of the contract and are not actionable in contract law. (There are many remedies for misrepresentation, and these are considered at §5-700—§5-705.) A representation may be the age, date or place of manufacture of a product.

1. *Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd* (1988) 5 BPR 11,110 at p 11,117 per McHugh JA (as he then was), citing eg Beale, H and Dugdale, T, *Contracts*

between businessmen (1975) 2 British Journal of Law and Society 45; noted (1994) 68 ALJ 457 and (book review) 46-8.

Determining whether a statement is a contractual term or a non-contractual representation may not be easy, but the following tests have been put forward by the courts to provide some help:²

- (1) How important was the truth of the statement?
- (2) Was the statement such that the aggrieved party would not have contracted unless it was true?
- (3) What time period was there between the statement and the final agreement?
- (4) Was the statement made with the intention of preventing the aggrieved party from finding any defects?³
- (5) Was the statement later omitted when the contract was reduced to writing?⁴
- (6) Did the party who made the statement have special knowledge or skill regarding the subject matter?

— *Case examples: special knowledge or skill* —

D sold P a second hand Morris 10 hp car described as a 1948 model. Six months later, after discovering it was a 1939 model, P claimed damages for breach of warranty but was unsuccessful on the basis that the statement as to age could not be shown to be a contractual term but only an innocent misrepresentation which gave no right to damages.

If this decision seems strange and perhaps unrealistic, it was because it was said that no “warranty” was given on the age of the vehicle. It was said that D (the vendor) had made the statement on reasonable grounds (the car’s registration papers) and that D had honestly believed it to be true. Lord *Denning* saw no warranty or guarantee being given, and traced this point of law back to a case in 1603⁵ where a person—

“... by word of mouth sold a precious stone for £100 affirming it to be a bezar stone whereas it was not. The declaration averred that the seller *affirmed* it to be a bezar stone, but did not aver that he *warranted* it to be so. The declaration was held to be ill because ‘the bare affirmation that it was a bezar stone, without warranting it to be so, is no cause of action’. That has been the law from that day to this...”

— *Oscar Chess Ltd v Williams*⁶ —

D (dealer) told P that the Bentley for sale had travelled only 20,000 miles on a replacement engine and gearbox. When P later discovered the car’s mileage was closer to 100,000, P was successful in damages for breach of warranty, because of various tests stated above: at least tests (1), (2) and (6) were fulfilled. As Lord *Denning* put it:

2. eg *Heilbut, Symons & Co v Buckleton* [1913] AC 30 at p 50.

3. *Hopkins v Tanqueray* (1854) 15 CB 130; 139 ER 369.

4. The problem of the parol evidence rule: see ¶5-030, ¶6-010.

5. *Chandelor v Lopus* (1603) Cro Jac 4; 79 ER 3.

6. [1957] 1 WLR 370 at p 376; [1957] 1 All ER 325 at p 331.

“... if a representation is made in the course of dealings for a contract for the very purpose of inducing the other party to act on it, and it actually induces him to act on it by entering into the contract, that is prima facie ground for inferring that the representation was intended as a warranty ... But the maker of the representation can rebut this inference if he can show that it really was an innocent misrepresentation, in that he was in fact innocent of fault in making it, and that it would not be reasonable in the circumstances for him to be bound by it.”

*Bentley (Dick) Productions Ltd v
Harold Smith (Motors) Ltd*⁷ —

There are many legal remedies for breach of pre-contractual representations in other areas of law, including misrepresentation (§5-700—§5-705), tort (§4-060), unconscionability at common law (§5-730) and under the *Trade Practices Act 1974* (Cth) for misleading or deceptive conduct (§7-250ff), false or misleading representations (§7-290ff) or unconscionability (§5-755).

¶6-030 Collateral contracts. Determining whether a statement is a non-contractual representation or a contractual term can be taken one step further if it can be shown that the statement has become a term of a “collateral” contract, that is, a contract for which the consideration is the making of the main contract.

— *Examples: collateral contract* —

The oral statement of a promisor (for example, the landlord) that the house is in good order can be the consideration for a tenant’s entering a written contract with the landlord that does not refer to this. If the property is not in good order, the tenant can sue on the collateral contract if the landlord’s oral statement has formed a contract which is *collateral* to the main contract in the written lease. The consideration for the collateral contract is the tenant’s entering the written contract with the landlord. The landlord’s statement, however, must be more than descriptive or representational and must qualify as promissory:

“For that representation to be converted into a promise there would have been required at least some further question such as ‘Can you promise that?’ and an affirmative answer.”⁸

*De Lassalle v Guildford*⁹ —

A paint manufacturer gave an assurance that its paint would last for seven years. On the strength of this, the consumer purchased the paint from the retailer under the main contract. When the paint gave way after three months,

7. [1965] 1 WLR 623 at p 627; [1965] 2 All ER 65 at p 67.

8. As was absent in *Ross v Allis-Chalmers Australia Pty Ltd* (1981) 55 ALJR 8; similarly absent in *Gates v The City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, noted (1986) 16 QLSJ 173;

¶7-280 (statements of insurer’s agent about benefits payable under a policy held to be descriptive, not promissory, and did not amount to a collateral contract).

9. [1901] 2 KB 215.

the consumer was able to recover from the manufacturer under the collateral contract for economic loss for breach of express warranty.

*Shanklin Pier Ltd v Detel Products Ltd*¹⁰

P entered a contract for the purchase of a motor cruiser. This contract (the main contract) was contained in correspondence between the parties. In one of the letters D gave several estimated speeds of motors that could be fitted to the boat. When the boat did not reach those estimated speeds P sued for breach of the main contract or alternatively breach of a collateral contract. The High Court held that the representation was neither a term of the main contract nor a term of a collateral contract. The estimate of the boat's speed was made with no intention of accepting contractual responsibility and P's claim of the existence of a collateral contract failed. In the words of the High Court:

"When the letter [setting out details] was written, the negotiations for the construction and delivery of the boat were incomplete. On receipt of the letter there were three courses open to [P]. He could have required the attainment of the speed to be inserted in the specification as a condition of the contract; or he could have sought from [D] a promise — however expressed, whether as an assurance, guarantee, promise or otherwise — that the boat would attain the speed as a prerequisite to his ordering the boat; or he could be content to form his own judgment as to the suitable power unit for the boat relying upon the opinion of [D] of whose reputation and experience in the relevant field he had, as the trial judge found, a high regard."

*JJ Savage & Sons Pty Ltd v Blakney*¹¹

A collateral contract — whether made before or at the same time as the main contract — is only valid and enforceable if it is consistent with the main contract so that the provisions of the main contract remain in force despite the collateral contract.

— *Case example* —

A four-year lease between B (the lessor) and C (the lessee) provided for termination on four weeks' notice. Action by C against B to resist termination — alleging a collateral contract that B would not exercise the right to terminate unless in turn required by B's head lessor (A) to terminate — failed on the grounds of inconsistency between the B-C sub-lease and the B-C collateral contract. B (the lessor) was entitled to terminate. In the words of *Knox CJ*,

"A distinct collateral agreement, whether oral or in writing, and whether prior to or contemporaneous with the main agreement, is valid and enforceable even though the main agreement be in writing, provided the two may consistently stand together so that the provisions of the main agreement remain in full force and effect notwithstanding the collateral agreement ...

10. [1951] 2 KB 854; [1951] 2 All ER 471.

11. (1970) 119 CLR 435; (1970) 44 ALJR 123.

There may be a contract the consideration for which is the making of some other contract.”

— *Hoyt's Pty Ltd v Spencer*¹² —

The requirement that the collateral contract must be consistent with the main contract has been criticised as this may go against the intention of the parties.¹³ This law is different in England, where an oral misrepresentation of the effect of an exclusion clause may prevent the exclusion clause from being incorporated in the contract.

— *Case example* —

A car park customer was able to recover compensation for the loss of jewellery and other valuables from his parked Rolls-Royce despite the printed car park ticket containing the usual exclusions. It was held that when the parking attendant promised to park the car and to lock it, a collateral contract was formed which overrode the printed parking ticket. In the words of Lord *Denning*, the exclusion clause in the ticket was inoperative “because the oral promise or representation has a decisive influence on the transaction — it is the very thing which induces the other to contract — and it would be most inequitable to allow the maker to go back on it. The printed condition is rejected because it is repugnant to the express oral promise or representation”. This principle is discussed further in the context of the operation of exclusion clauses at ¶6-180 and the bailee's duty of care at ¶15-080.

— *Mendelssohn v Normand Ltd*¹⁴ —

Before the courts will infer a collateral contract there must also be evidence that the representee actually entered the main contract in consideration of the collateral promise. This could not be proved in the *Blakney* case above.

Statements that may give rise to a collateral contract may be actionable as unconscionability at common law (¶5-730), and under the *Trade Practices Act 1974* (Cth) as misleading or deceptive conduct (¶7-250ff), false or misleading representations (¶7-290ff) or unconscionability (¶5-755).

¶6-040 Statements regarding the contract. Not all statements are terms of the contract (¶6-010), or even representations (¶6-020), and a statement which is not a term of a contract may be:

- an invitation to treat (¶5-150);
- mere “puffery” or sales talk (¶5-080);
- a statement of opinion or of law;

12. (1919) 27 CLR 133 at p 139; Phillips, JC and Carter, JW, *The demise of Hoyt's Pty Ltd v Spencer* (1989) 2 JCL 181.

13. eg Greig, DW and Davis, JLR, *The Law of Contract*, The Law Book Co Ltd, 1987, pp 503-513, cited eg *Shepherd v National Mutual Life Association of*

Australasia Ltd (1995) 8 ANZ Insurance Cases ¶61-233 at pp 75,612-75,613. “The law relating to collateral contracts is not free from difficulty”: *Bardenhagen v Tasmanian Board Mills Ltd* (1994) 4 Tas LR 270 at p 275.

14. [1970] 1 QB 177 at p 184.

- the supply of information;
- a representation of fact which has substantially induced the entry into the contract (¶5-700; ¶6-020);
- a representation of intention;
- an independent or collateral contract (¶6-030).

Statements which are not terms of the contract may also be actionable as negligence (¶4-060), unconscionability at common law (¶5-730) and under the *Trade Practices Act 1974* (Cth) as misleading or deceptive conduct (¶7-250ff), false or misleading representations (¶7-290ff) or unconscionability (¶5-755).

Having established which stipulations are terms of the contract, the next step is to work out their relative importance. Contracts usually contain many terms of which some are critical and others less critical. The traditional distinction is between *conditions* and *warranties* (see ¶6-050 below).¹⁵

Amendment of the terms of a contract. The terms of a contract may be amended by:

- discharge of the existing contract and creation of a new contract in its place (¶6-310);
- discharge of the existing contract conditional upon creation of a new one in its place by “novation” (eg ¶10-360); or
- leaving the existing contract in place, but changing some of its terms by variation of the original contract.

Legislation provides for amendment in various situations such as impossibility of performance (frustration: ¶6-350—¶6-370). The *Year 2000 Information Disclosure Act 1999* (Cth) provides that the making of a Year 2000 disclosure statement is taken not to “amend, alter or vary” a contract unless the parties have expressly so agreed (sec 15).

¶6-050 Conditions and warranties. A “condition” is a term which is vital to the contract, breach of which entitles the injured party to repudiate the contract and to treat the injured party’s obligations as at an end, and/or to sue for damages for loss suffered as a result of the breach. In other words, the injured party or representee has two available choices:

- to affirm the contract and bring an action for damages, or
- to terminate (ie treat the contract as never having existed).

A “warranty” on the other hand is a lesser term or a minor term of the contract which is subsidiary to the main purpose of the contract. If a warranty is breached, the contract does not come to an end. The injured person must still perform under the contract, but has the right to sue for damages for loss for breach of warranty.

15. Except in insurance contracts: see ¶17-650.

To determine if a term is a condition or warranty depends on whether or not it is essential or vital to the contract:¹⁶

“The question whether a term in a contract is a condition or a warranty, ie, an essential or a non-essential promise, depends upon the intention of the parties as appearing in or from the contract. The test of essentiality is whether it appears from the general nature of the contract considered as a whole, or from some particular term or terms, that the promise is of such importance to the promisee that he would not have entered into the contract unless he had been assured of a strict or a substantial performance of the promise, as the case may be, and that this ought to have been apparent ... If the innocent party would not have entered into the contract unless assured of a strict and literal performance of the promise, he may in general treat himself as discharged upon any breach of the promise, however slight. If he contracted in reliance upon a substantial performance of the promise, any substantial breach will ordinarily justify a discharge. In some cases it is expressly provided that a particular promise is essential to the contract, eg, by a stipulation that it is the basis or of the essence of the contract: *Bettini v Gye*; but in the absence of express provision the question is one of construction for the Court, when once the terms of contract have been ascertained ...”

— Case example —

A “dramatic artist and professional singer” entered a performance contract with a promoter, from 30 March to 13 July 1875; she was to be in London without fail at least six days before the commencement of the engagement for rehearsals. The singer arrived on 28 March (four days late) because of illness, and the promoter purported to rescind the contract. It was held that the provision as to rehearsal was not a condition precedent (¶6-060) because it did not go to the root of the matter. It was considered to affect only the performances in theatres but not performances otherwise specified in the contract. As it had only a partial effect on the contract, compensation by damages was considered adequate. The singer was therefore liable to the promoter in damages for breach of contract.

In determining whether there was a breach of condition (major term) or only a breach of warranty (minor term), the court had to look at a number of factors. What would be the effect on rehearsals of being four days late? Was literal fulfilment of the rehearsal period crucial? Was it clear that the contract would be cancelled if the rehearsal period was not complied with? What if the plaintiff had performed the same role many times and needed little rehearsal?

— *Bettini v Gye*¹⁷ —

16. *Tramways Advertising Pty Ltd v Luna Park (NSW) Ltd* (1938) 38 SR (NSW) 632 at pp 641-642. Illustrating the flexibility of the English language, the word “condition” has at least 11 different

legal usages: see Stoljar, SJ, *The contractual concept of condition* (1953) 69 LQR 485 at pp 486-488.

17. (1876) 1 QBD 183; [1874-80] All ER Rep 242.

In another case in the same year,¹⁸ where the singer in question failed to appear on the opening night because of illness, the promoter was held to be entitled to repudiate the contract and to sack her. What courses were open to the promoter? As it was a serious illness preventing her appearance, he could withdraw the opera or employ a temporary substitute, and on either alternative possibly suffer heavy loss. It followed that the failure on the singer's part went to the root of the contract and discharged the promoter, who was free to engage another full time performer.

¶6-060 Condition precedent. A condition precedent is a precondition which delays a right arising until some event has happened. A condition precedent is not always a "condition" as used in contract law to mean an essential term (¶6-050); some conditions precedent may involve minor matters which would normally be analysed in contract law as a warranty.

A "condition precedent" has two meanings in contract law. It may indicate:

(1) *a condition precedent to the formation or existence of a contract.* The transaction creates no rights enforceable by the parties unless and until the condition is fulfilled. For example, if there is conditional acceptance of an offer, such as acceptance "subject to contract" (¶5-250), no contract is formed if the "subject to ..." does not occur.

— *Case example* —

The parties had negotiated for the sale of a three-eighths share in a certain invention, but the memorandum of agreement stated that it was not to be binding unless the invention had first been approved by a third party. This approval was a condition precedent to the contract coming into existence. Without it there was no contract.

_____ *Pym v Campbell*¹⁹ _____

(2) *a condition which is precedent to the obligation of a party to perform its part of the contract.* In this case, there is a binding contract which creates enforceable rights, but the obligation of a party or perhaps both parties to perform depends on fulfilment of the condition precedent. The contract is not binding unless and until this precondition occurs. Unless the car is delivered by 9.00 am on Wednesday morning, there is no binding contract. Unless the car passes its mechanical test, I will not buy it. Non-fulfilment of the condition precedent entitles the other party to terminate.

— *Case examples* —

A real estate contract dated April 1978 contained a condition precedent that it was entered into "subject to Purchasers completing a sale of their property". After notice to complete, the vendor rescinded the contract in August 1978. The purchasers contracted to sell their property in March 1979, and completed the sale in June 1979. They then wanted to go ahead with the earlier contract,

18. *Poussard v Spiers* (1876) 1 QBD 410.

19. (1856) 6 E & B 370; 119 ER 903.

and unsuccessfully disputed the vendor's right to rescind. Sale of the purchasers' property had been "a condition precedent to the performance of certain of the obligations of the parties under the contract, including the obligation of the [vendor] to complete the sale". Since the purchasers had not sold their own property within a reasonable time the condition precedent had not been complied with and the court held that the vendor had been correct when he rescinded the contract in August 1978.

_____ *Perri v Coolangatta Investments Pty Ltd*²⁰ _____

A real estate contract contained a special condition that the contract was "subject to and conditional upon" approval of a plan of subdivision by the local council on conditions satisfactory to the purchaser. This approval "was expressed in the form of a condition precedent, but it was a condition precedent not to the formation of the contract but to the obligation to complete it". When the subdivision was not approved, the purchaser wanted to waive the condition precedent and to complete the contract. The High Court held that the condition precedent gave the purchaser the choice of cancelling. If the purchaser did not choose to cancel the contract for the failure to obtain council approval, the vendor could not treat the contract as at an end and must perform under the contract.

_____ *Sandra Investments v Booth*²¹ _____

A condition precedent is an example of the parties to the contract themselves providing in the contract for discharge: ¶6-310.

¶6-070 Condition subsequent. A condition subsequent refers to an obligation which must be complied with after the contract is made. If the obligation is not fulfilled, the other party can terminate on non-fulfilment. There is a binding contract which creates rights which can be enforced, although the obligation of a party or perhaps both parties to perform depends on fulfilment.

For example, A and B might enter a contract which is to continue "so long as supplies continue". If supplies run out, the contract will come to an end. Insurance policies contain notice of loss clauses which require the insured to notify the insurer of loss or other event arising under the policy within x number of days (¶17-710). If there is non-fulfilment, the burden of proof is on the insurer to prove that the condition was not satisfied.

As with conditions precedent, failure of a condition subsequent may affect the whole contract or part only of the contract (in which case, the agreement remains in force and action can be taken in damages).

Condition precedent or condition subsequent? The same conduct may sometimes be analysed as either a condition precedent or a condition subsequent: the same condition "is precedent to the obligation of a party to perform his part of the contract and is subsequent in the sense that it entitles the party to terminate the contract on non-fulfilment".²² Failure of the

20. (1982) 149 CLR 537; (1982) 56 ALJR 445. 22. *Perri's case* (¶6-060 above) at CLR p 555; ALJR p 450.

21. (1983) 153 CLR 153.

purchasers to sell their property in the *Perri case* above was non-fulfilment of a condition subsequent which gave the vendor the right to terminate.

¶6-090 Condition or warranty? As a legal definition of conditions and warranties is not as important as the need to pick the difference — the difference is provided by the construction or analysis of the contract (¶6-050). The cases establish that analysis of a statement as a representation, a term of the contract (ie condition or warranty), or a collateral contract, depends on the objective intention of the parties to be deduced from the whole of the circumstances of the case. Classification may be arbitrary and all too often “the court appears to decide whether the remedy sought would be appropriate in all the circumstances, and then classifies the statement appropriately; and one is left with no more reason than the bald assertion that it does or does not appear that the importance of this statement to the parties was such as to justify the relief sought.”²³ This approach allows flexibility, but it also leads to uncertainty in the law, fine distinctions and the inability to know whether to repudiate and sue for damages (breach of condition) or persevere and sue for damages (breach of warranty). Whether the breach will allow the injured party to treat the contract as being at an end has traditionally been tested by the concept of essentiality. Consider these examples:

— *Case example* —

Bancks, the creator of the character of Ginger Meggs, entered an agreement with the plaintiff (Associated Newspapers Ltd) under which he agreed to prepare and furnish a full page comic, “Us Fellers”, for ten years. The plaintiff undertook that it would be presented on the front page of the comic section of the *Sunday Sun and Guardian*. Due to a newsprint shortage, and after the contract had run two years, the plaintiff newspaper printed the comic on page three for three successive weeks in February 1951 (and intended to do so for several more). Bancks regarded this as a breach of a condition of his contract with the newspaper, repudiated and held himself to be no longer bound by the contract. When Bancks was sued by the newspaper, the question was whether the undertaking to publish “Us Fellers” on the first page was a condition or a warranty. It was held to be a condition of the contract and that Bancks was fully within his contractual rights to do as he did.

— *Associated Newspapers Ltd v Bancks*²⁴ —

The question whether the front page stipulation was a condition or warranty was related back to the root of the contract test: does the stipulation go to the root of the matter so that failure to perform it would render the performance of the rest of the contract by the plaintiff a thing different in substance from what the defendant has stipulated for, or does it only partially affect it so that it can be compensated for in damages? This point was

23. Allan, DE, *The scope of the contract — affirmations or promises made in the course of contract negotiations* (1967) 41 ALJ 274 at p 276.

24. (1951) 83 CLR 322 at p 336.

expressed in different ways by reference to the authorities: “You look at the stipulation broken from the point of view of its probable effect or importance as an inducement to enter into the contract.” In other words, the test applied was that of essentiality.

— *Case example* —

The owner of a house, when instructing an agent to sell, indicated on a form supplied by the agent that the house was sewered. In fact this was not the case and after the sale this was discovered by the purchasers who sued the vendor for damages for breach of warranty, or alternatively for negligent misrepresentation. It was held:

- (1) the representation that the house was sewered amounted to a warranty forming part of the contract, and the purchasers were entitled to an award of damages of the cost of sewerage of the house;
- (2) the claim for negligent misrepresentation failed because damage was the gist of the action and the purchasers had not shown that the house was worth less than the price paid.

— *Ellul and Ellul v Oakes*²⁵ —

The test to apply would be whether the stipulation was essential to the contract. If so, it would be a condition, breach of which would justify repudiation; if not, it would be a warranty, breach of which would justify an award of damages only. It was the latter which was found applicable in this case, and an award of damages (the cost of connecting the sewer) was made.

The parties to the contract may choose if a term is to be treated as a condition or a warranty; if there are problems of definition, any dispute may have to be settled by the courts.

¶6-095 Innominate terms. Sometimes the effect of a term cannot be classified as a condition or a warranty until after a breach of contract has taken place and its seriousness analysed. The division of contract terms into conditions and warranties presumes that the importance of all terms is clear, yet contract law traditionally allows repudiation by the innocent party for a minor breach of a major term (breach of condition), and only damages for a major breach of a minor term (breach of warranty).

To overcome this imbalance, the judgment in the *Hong Kong Fir case* directed attention to the effect of the breach, rather than classification of the term broken, by recognising an innominate or intermediate term as a contractual term the importance of which lies between a condition and a warranty. Hence the breach of what seems like a minor term, if it has a serious effect, could bring the contract to an end. If the breach is not major — even if described as a breach of a “condition” — it does not bring the contract to an end.

25. (1972) 3 SASR 377.

— *Case examples* —

The plaintiff shipowners chartered a ship to D for a two-year period. In the charter P had contracted (amongst other things) that the ship was seaworthy. When the ship was delivered for charter, it was found to be in such poor condition that for some 20 weeks of the first 30 weeks of the charter it was under repair to make it seaworthy. D repudiated for unseaworthiness and was successfully sued by P for breach of contract. D's argument that seaworthiness was a condition the breach of which entitled it to repudiate was rejected: the English Court of Appeal held that P's rights did not depend on the nature of the term broken, but on the event which resulted from the breach of contract. Although P was in breach of its obligation to provide a seaworthy ship, this did not amount to a breach of condition. D should not have repudiated but should have claimed damages for compensation for lost time.

The essentiality test was redefined by the court:

"... the problem in this case is, in my view, neither solved nor soluble by debating whether the shipowners' express or implied undertaking to tender a seaworthy ship is a 'condition' or a 'warranty'. It is, like so many other contractual terms, an undertaking one breach of which may give rise to an event which relieves the charterer of further performance of his undertakings if he so elects, and another breach of which may not give rise to such an event but entitle him only to monetary compensation in the form of damages ...

What the judge had to do in the present case ... was to look at the events which had occurred as a result of the breach at the time at which the charterers purported to rescind the charterparty and to decide whether the occurrence of those events deprived the charterers of substantially the whole benefit which it was the intention of the parties as expressed in the charterparty that the charterers should obtain from the further performance of their own contractual undertakings."

— *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*²⁶ —

D, a German manufacturer, appointed P as its UK distributor under a contract which contained 20 terms, of which one was called a condition. This term provided (amongst other things) that "it shall be [a] condition of this agreement that ... [P] shall send its representatives to visit [certain manufacturers] at least once in every week for the purpose of soliciting orders". Another term provided that either party could terminate the contract if one committed a "material" breach and failed to remedy it within 60 days of being required to do so by the other.

During the first eight months of the contract, P committed certain "material" breaches but these were waived by D. In the following six months, P committed certain minor breaches and as a result D attempted to repudiate the contract.

26. [1962] 2 QB 26 at pp 71-72; [1962] 1 All ER 474 at p 488.

The court held that this first term was not a condition as understood in the law of contract (¶6-050) which entitled the innocent party to repudiate for breach. For example, the sales representatives were named in the contract and there was no provision for what was to happen if the named person was sick or was to retire or die. There was no provision for what was to happen if a manufacturer would not receive a representative. The court recognised the confusion surrounding the use of the word "condition" because of the specialised meaning of "condition" in the law of contract, and confirmed that to call a term a condition does not necessarily make it a condition as understood in the law of contract:

"it has now been made explicit that there lies intermediate between conditions and warranties a large 'innominate' class of contractual terms (*any* breach of which does not give rise to a right in the other party to terminate the contract, but only a material breach, immaterial breaches merely giving rise, like breaches of warranty, to a right to claim damages)".

_____ *L Schuler AG v Wickman Machine Tool Sales Ltd*²⁷ —

In breach of a contract of guarantee (¶13-360—¶13-380), the owner of leased machinery (the creditor) failed to notify the guarantor when the lessee (the debtor) defaulted under the contract and also assigned its interest in the machinery. The High Court held that these breaches by the creditor of promissory terms of the guarantee requiring strict performance discharged the guarantor from liability (even though "the provisions are not expressed to be conditions"):

"In deciding whether a promise has the status and effect of a condition, courts are not too ready to construe a term as a condition and, at least where other considerations are finely balanced, will hold that a term is of such a kind that breach of it does not give rise to an automatic right to rescind. This approach is explained by a preference for a construction that will encourage performance rather than avoidance of contractual obligations.^[28]"

_____ *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd*²⁹ —

The Commonwealth government (D) terminated Amann Aviation's (P's) aerial observation contract because P's aircraft were not fully ready in various minor ways on the first day. The High Court, in awarding damages to P, held that because P had not repudiated the contract to deprive D of its benefit, D was not entitled to rescind. Contract clauses, even though described as conditions, were restricted, so D could not rescind for inconsequential breaches by P.

_____ *The Commonwealth of Australia v Amann Aviation Pty Ltd*³⁰ —

27. [1974] AC 235 at p 264; [1973] 2 WLR 683 at p 701.

28. *Cehave NV v Bremer Handelsgesellschaft mbH* [1976] 1 QB 44 at pp 70-71; *Bunge Corporation New York v Tradax Export SA Panama* [1981] 1 WLR 711 at pp 715-716; [1981] 2 All ER 513 at pp 541-542.

29. (1987) 162 CLR 549 at p 556; (1987) 61 ALJR 245 at p 247.

30. (1990) 22 FCR 527 (Full Federal Court); appeal to High Court on damages upheld: (1991) 174 CLR 64; (1991) 66 ALJR 123, ¶6-455.

As a result of these cases, it is now clear that labelling a term as a condition does not necessarily determine its legal effect:³¹

“The use of the word ‘conditional’ ... is of itself inconclusive; ‘condition’ is used in contracts in a variety of senses and does not necessarily mean only a term of a contract any breach of which, however minor, by one party entitles the other party to treat it as a wrongful repudiation of the contract and to elect to accept it as putting an end to all primary obligations of both parties under the contract that had not yet been performed.”

¶6-100 Implied terms of the contract. In addition to its express terms, a contract contains many terms read into the contract by the parties or by the courts which are called “implied terms”. These fill the spaces between the lines in the contract:

- (1) Terms may be implied to give the contract “business efficacy” — to help make sense of the contract (¶6-110);
- (2) Terms may be implied or read in from custom or business usage (¶6-120).
- (3) Sometimes, terms can be implied from previous dealings (¶6-130).
- (4) Some terms are implied by statute, which in some cases cannot be excluded (¶6-140).
- (5) There are the terms filled in by the courts to define uncertain, meaningless or ambiguous terms (¶6-150—¶6-170).
- (6) Terms may be implied from the express words of the contract or from the nature of the contract, and
- (7) Terms may be implied from the common intention of the parties.

¶6-110 Terms implied by the courts. In addition to the terms actually agreed to between the parties, the court may imply terms into a contract to give effect to what the parties presumed or understood. However, “a term is not implied in a contract if the contract is effective without it.”³² Terms may be implied from business or trade usage (¶6-120) or from past dealings between the parties. It is only where a dispute arises that the matter of defining the implied terms becomes important: just what did “fair average quality” really mean?

When the court reads in an implied term, it is doing what it believes is necessary to give effect to the intention of the parties — to give “business efficacy” to the contract, so that the contract will achieve what the parties intended.

31. *Australia and New Zealand Banking Group Ltd v Beneficial Finance Corporation Ltd* [1983] 1 NSWLR 199 at p 204; (1983) 57 ALJR 352 at p 355 (Privy Council).

32. *Breen v Williams* (1996) 186 CLR 71, per Brennan CJ at p 80.

— Case example

In *The Moorcock*, D, a wharfinger, contracted with P, a shipowner, to discharge cargo at D's jetty. Both parties knew that P's ship would go aground if moored to the jetty at low water but neither expected any damage to be caused by this. The tide ebbed while the ship was being unloaded and she was damaged when she settled on a hard ledge beneath the mud. P sued D, alleging it was reasonably implicit that D had warranted that the river bed adjoining the jetty was in such a condition as not to cause damage to the ship. Although this matter was not mentioned in the contract, the court's answer was:

"What, then, is the reasonable implication in such a contract? In my opinion honest business could not be carried on between [P] and [D] unless the latter had impliedly undertaken some duty towards [P] with regard to the bottom of the river at this place. If that is so, what is the least onerous duty which can be implied?"

*The Moorcock*³³

In giving effect to the presumed intention of the parties, judgment in damages for breach of an implied term of the contract was given in the plaintiff's favour on the basis that the defendant had impliedly represented that reasonable care had been taken to determine that the river bed could accommodate the ship with safety.

The conditions to be satisfied before a term may be implied into a contract by the courts were stated by the Privy Council as follows:³⁴

"... for a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract."

Australian contract law recognises a general implied duty of good faith and fair dealing in contract performance.³⁵

Implied terms have been held to include a duty to use reasonable care,³⁶ a negative covenant that a television company would not make the plaintiff actors' proposed television series using other actors,³⁷ and a duty of parties to a contract to co-operate to bring about the requirement of the contract.³⁸

33. (1889) 14 PD 64; [1886-90] All ER Rep 530; applied eg *Esso Australia Resources Ltd v Plowman* (1995) 69 ALJR 404.

34. *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of The Shire of Hastings* (1977) 180 CLR 266 at p 283.

35. *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1, per Finn J at pp 37-38.

36. *Esso Petroleum Co Ltd v Mardon* [1976] 1 QB 801; ¶5-700.

37. *Fraser v Thames Television Ltd* [1984] 1 QB 45 (Thames Television held in breach of contract for failing to offer to Rock Bottom members roles in "Rock Follies", a series they developed); ¶3-685.

38. *RDJ International Pty Ltd v Preformed Line Products (Australia) Pty Ltd* (1996) 39 NSWLR 417.

There is an implied term in a contract for work that the contractor will use reasonable care and skill and do the work in a “workman-like” manner (¶7-095).³⁹

The court will not imply a term in order to make an agreement legally enforceable if the parties have not yet reached a concluded agreement.⁴⁰

Implied term of good faith. Good faith, which is one of the foundations of Australian law, may be implied by the courts as a term of the contract binding on the parties to the contract. This imposes a duty of fair dealing, which involves a duty of good faith both in performing obligations and in exercising rights.⁴¹

Good faith involves:

- an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself);
- compliance with honest standards of conduct; and
- compliance with standards of contract which are reasonable having regard to the interests of the parties.

— Case example —

Implied term: business efficacy. An agreement, which was described as “a legally binding Agreement” was subject to various conditions which the parties had fulfilled. The fact that the parties had stated that they “shall embody the terms of this Agreement in appropriate long form Agreements” indicated that the agreement was intended to be less than an exhaustive statement of the parties’ contractual intention. However, the court was not prepared to enforce the agreement as a contract by implying as necessary a term to give a reasonable or effective operation to a contract of that nature in the circumstances of this case.

— *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd*⁴² —

¶6-120 Terms implied from custom or business usage.

Business or trade usage may be read into a contract to give effect to its terms even though it has not been specifically lined up between the parties (as long as it is not contrary to their express intention). In a classic case,⁴³ an

39. *Zorba Structural Steel Company Pty Ltd v Watco Pty Ltd* (1993) 115 FLR 206.

40. *Australia and New Zealand Banking Group Ltd v Frost Holdings Pty Ltd* [1989] VR 695, noted (1991) 65 ALJ 59 (no definite agreement regarding price, quality, size, style, etc. Similarly, *Hawkins v Clayton* (1988) 164 CLR 539, per Deane J at pp 571, 573; *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at p 422. Uncertain terms could not be determined by reference to previous dealings as in *Hillas & Co Ltd v Arcos Ltd*, ¶6-130, ¶6-150).

41. *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349. See further Brazil, P, *Good faith and reasonableness in commercial transactions*, in Mugasha, A, *Perspectives on Commercial Law*, Ch 5, Prospect Media Pty Ltd, 1999; Edwards, J, *Negotiating parties and equitable estoppel: is there a duty of good faith?* (1999) 27 ABLR 300.

42. (1998) NSWLR 104.

43. *Hutton v Warren* (1836) 1 M & W 466; 150 ER 517.

agricultural tenant who had been given notice to quit claimed an allowance for seeds and labour in planting the field just before his departure. There was no mention of this in the lease, but it was held that the lessee was entitled to recover this amount because custom required a tenant to plough and to sow and custom also required a landlord to pay for this work. In other words, where a known usage has been established, the presumption is that this forms part of the contract.

The High Court confirmed the following four propositions as stating the circumstances in which trade custom or usage may form the basis for the implication of terms into a contract:⁴⁴

“(1) The existence of a custom or usage that will justify the implication of a term into a contract is a question of fact ...

(2) There must be evidence that the custom relied on is so well known and acquiesced in that everyone making a contract in that situation can reasonably be presumed to have imported that term into the contract ...

(3) A term will not be implied into a contract on the basis of custom where it is contrary to the express terms of the agreement ...

(4) A person may be bound by a custom notwithstanding the fact that he had no knowledge of it ... a person would be presumed to know of the usage if it was of such notoriety that all persons dealing in that sphere could easily ascertain the nature and content of the custom. It would then be reasonable to impute that knowledge to a person, notwithstanding his ignorance of it”.

¶6-130 Terms implied from previous course of dealing.

Terms may be read in or implied from previous dealings. In doing so, the courts are influenced by whether a contract is a consumer or a commercial contract, whether the term is reasonable and whether such a term is usually found in similar contracts. A court will try to uphold an agreement, even one with uncertain terms (¶6-150).

— Case example —

A written agreement for the supply of wood in 1930 contained an option to buy more wood in the following year which did not specify details of the wood to be supplied under the later agreement. The court held that the points not specifically decided in the option could be determined by reference to the previous dealings between the parties as well as normal business practice in the timber trade, ie that the same wood would be supplied.

— *Hillas & Co Ltd v Arcos Ltd*⁴⁵ —

44. *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) 160 CLR 226 at pp 236-237 (citations omitted). See further

Latimer, P, *Stock exchange usage* (1990) 8 C & SLJ 165.

45. [1932] All ER Rep 494; see ¶6-110, ¶6-150.

For example, if a contract were made hurriedly over the phone, it would be expected to be made subject to the usual conditions.⁴⁶

¶6-140 Terms implied by statute. Various statutes imply terms into a contract, such as the terms concerning fitness, merchantability and description of goods which form part of every sale of goods contract (¶7-035ff). These terms are implied in the Sale of Goods Acts in all jurisdictions as well as by the *Trade Practices Act 1974* (Cth). There are similar implied terms in hire-purchase contracts about description, fitness and quality of goods. Where goods are sold by sample, the sample must exactly correspond with the bulk (see ¶7-100). Many other statutes imply contractual terms — for example, sec 14 of the *Mercantile Law Act 1962* (ACT) provides that if the parties to a contract have not agreed on a rate of interest, then interest at the rate of eight per cent will be the maximum recoverable. Car traders' legislation implies statutory warranties into the contract of sale of a second hand vehicle (¶7-600).

The operation of statutory terms can sometimes be limited by the parties if the statute so provides.⁴⁷ Some statutory terms are excludable although the general trend, especially in consumer transactions, is to make statutory implied conditions non-excludable (¶7-170—¶7-205). Even to include an exclusion may be a false or misleading statement concerning the exclusion of a condition and may thus constitute an offence under the *Trade Practices Act 1974* (Cth) sec 53(g) (¶7-370).

¶6-150 Uncertain terms. The problem with terms in an “agreement” that are unclear or uncertain is that their very presence may indicate no real agreement between the parties. However, a contract containing an ambiguity is not necessarily uncertain or incomplete, and if possible the courts will try to give effect to the intention of the parties to preserve their contract. Sometimes a court may be able to “sever” an uncertain provision so that the rest of the contract can operate.

— Case examples —

A van was purchased “on the understanding that the balance of the purchase price could be had on hire-purchase terms over a period of two years”. Had the parties agreed to anything? True, the courts can imply terms to give effect to the intention of the parties (¶6-110), but the question in this case was whether any contract had ever really been concluded. The answer was in the negative, and two reasons were given why the court could not hold that there was ever a contract in existence:

- (1) the language used was so obscure and so incapable of any definite or precise meaning that no contractual intention could be attributed to the parties, and

46. See further Swanton, J, *Incorporation of contractual terms by a course of dealing* (1989) 1 JCL 223.

47. Such as those in the *Trade Practices Act 1974* (Cth) sec 68A. See ¶7-170.

- (2) in fact, there was no evidence that the parties had ever reached real agreement. The court was not prepared to define “hire-purchase terms” and therefore make the contract for the parties.

— *Scammell and Nephew Ltd v Ouston*⁴⁸ —

In comparison, the court was prepared to put meaning into the subject matter of an option agreement. The details of the wood to be supplied were held to be the same as those of the agreement of the contract of the previous year and the test of certainty was satisfied. An existing contract, with specifications clear and accepted, was seen as quite different from a new contract with as yet undefined terms.

— *Hillas & Co Ltd v Arcos Ltd*⁴⁹ —

The courts will not enforce an incomplete agreement such as an agreement to agree at some time in the future. But if there is sufficient certainty in the intentions of the parties, such as the parties having worked out “heads of agreement”, the courts will give effect to the reasonable expectations of the parties.

— *Case example* —

Too uncertain. A proposal by Unilever to acquire the interests of Fabergé was too uncertain to create a binding contract. The words used were too imprecise, such as references to a “proposal”, not a “contract”. They included “This proposal is ... conditional upon the negotiation of documentation” and “The transaction we propose”.

— *Fabergé Australia Pty Ltd v Unilever Australia Ltd*⁵⁰ —

The following clauses have been upheld as not void for uncertainty: purchase of fish at “cost to [supplier] + percentage profit margin”;⁵¹ an agreement calling for performance within a reasonable time;⁵² and an undertaking to pay interest.⁵³ In contrast, the following have been held to be void for uncertainty:

- the promise by an employer to an employee of a salary package including “the option to participate in the company’s senior staff equity sharing scheme” (which did not yet exist) — this could not be valued by reference to any external standard;⁵⁴
- a loan repayable when the borrower “could afford to do so” — as the time of repayment could not be determined. Did this mean when the

48. [1941] AC 251; [1941] 1 All ER 14; ¶5-260.

49. [1932] All ER Rep 494, ¶6-110, ¶6-130.

50. (1993) 6 BPR 13,752 (NSW Court of Appeal) (emphasis added).

51. *Trawl Industries of Australia Pty Ltd v Effem Foods Pty Ltd Trading as “Uncle Bens of Australia”* (1992) 27 NSWLR 326.

52. *Whitehouse Properties Pty Ltd v Bond Brewing (NSW) Ltd* (1992) 28 NSWLR 17.

53. *Edwards v Victorian Producers Co-operative Co Ltd* (1993) ASC ¶56-233 (Full Court, SA).

54. *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130.

borrower could afford to pay from income, capital, gross profits or net profits?⁵⁵

¶6-160 Meaningless terms. A meaningless term is something different from an uncertain term — the latter indicates no real agreement, the former indicates something agreed, to which on reflection no meaning can be attributed. In *Nicolene Ltd v Simmonds*,⁵⁶ the defendant accepted an order for goods from the plaintiff in a letter in which he said, “We are in agreement that the usual conditions of acceptance apply”. There were no usual conditions of acceptance and the words were therefore meaningless. In the context of a definite concluded agreement, with nothing else to be settled between the parties, this unnecessary clause was ignored as having no effect. *Denning* LJ drew a distinction between “a clause which is meaningless and a clause which is yet to be agreed”. The former can be severed from the contract leaving the contract standing as agreed by the parties.

¶6-170 Ambiguous terms. Where a term has more than one meaning, the contract is not necessarily void for uncertainty so long as it is capable of being given meaning by the courts or an arbitrator. The question is that of construction or interpretation, which will be possible as long as the language is not so obscure as to be incapable of having any definite meaning indicating contractual intention. Commercial agreements especially enable the courts to avoid narrow or pedantic approaches and to read in some business sense. In the *Upper Hunter case*,¹ the term in question was that of the meaning of “supplier’s costs”: “It is agreed that during the term of this agreement if the supplier’s costs shall vary in other respects than has been hereinbefore provided the supplier shall have the right to vary the maximum demand charge ...”

The High Court, reversing the decision of the court below, held that this expression was quite clear.

“I do not think there is any uncertainty or for that matter ambiguity in the expression ‘supplier’s costs’ ... A contract to build a bridge at cost could not, in my opinion, be held void for uncertainty: it could not properly, in my opinion, be said to be meaningless: nor is it, in my opinion, ambiguous. Endless might be the arguments pro and con as to whether or not in marginal cases some item of expenditure is as claimed a cost, or as to how much of an expenditure is a cost, of the particular activity. But to my mind, generally speaking, the concept of a cost of doing something is certain in the sense that it provides a criterion by reference to which the rights of the parties may ultimately and logically be worked out, if not by the parties then by the courts.”

55 *Universal Greening Pty Ltd v Sabine* (1999) 17 ACLC 880, noted (1999) 73 ALJ 864.

56. [1953] 1 QB 543; [1953] 1 All ER 822.

1. *The Council of the Upper Hunter County District v Australian Chilling and Freezing Co Ltd* (1968) 118 CLR 429, per *Barwick* CJ at p 437.

¶16-180 Exclusion clauses. When a contract contains an “exclusion clause” or “exemption clause” or “limitation of liability” clause, the rights of one party to the contract are in some way limited under the contract. If a problem arises, the court may have to intervene to allow the intention of one party to the contract to prevail over the other’s intention or understanding even though the latter may have been unaware of the exclusion clause or its possible effect.

Exclusion clauses are common, and range from the limitation of liability to be found on the back of a bus or train ticket to agreed damages clauses in large business contracts. (See, for example, the exclusion clause in the bank’s “stop payment” notice, ¶16-130.) Cases have concerned the full range including train tickets, parking station tickets and dry cleaning tickets through to million dollar charterparties.

In many everyday situations, a person is presented on a “take it or leave it” basis with a “ticket” or “voucher” which may be a “standard form contract”. (On standard form contracts see ¶5-780—¶5-790.) There is generally little or no time to read the fine print on the back of the document and even less opportunity to negotiate changes to any clauses found unacceptable or objectionable.

The current operation of exclusion clauses is governed by the following propositions:

- (1) A signatory is bound by an exclusion clause contained in a signed document (¶16-190).
- (2) If the exclusion clause is contained in an unsigned document:
 - (a) it is not effective if the document is a non-contractual voucher, receipt or ticket (¶16-200);
 - (b) it is effective if sufficient notice is given (¶16-210).
- (3) Notice of the exclusion clause after formation of the contract renders the clause ineffective (¶16-220).
- (4) Previous dealings may lead to the inference of sufficient notice of the exclusion clause (¶16-230).
- (5) Special rules may apply to the interpretation of exclusion clauses (¶16-240).
- (6) A collateral contract may override the operation of an exclusion clause, as in *Mendelssohn v Normand Ltd*² (¶16-030).
- (7) Third party C (such as an employee) may be able to gain protection under an exclusion clause in the contract between A and B (¶16-265).
- (8) The operation of exclusion clause principles has been severely curtailed, especially in the consumer context, by various statutory initiatives: in consumer law under the *Trade Practices Act 1974* (Cth) and equivalents

2. [1970] 1 QB 177.

(¶7-120, ¶7-170—¶7-205, ¶7-370), sale of motor vehicles law (¶7-610), consumer credit law (Chapter 14), and in the prohibition of exclusion of a complaint from the Small Claims Tribunal (¶7-720).

- (9) The operation of an exclusion clause may constitute conduct which is “misleading and deceptive” and therefore actionable under sec 52 of the *Trade Practices Act 1974* (Cth) (¶7-281).
- (10) An exclusion clause may be unconscionable at common law (¶5-730) or under the *Trade Practices Act 1974* (Cth) (¶5-755—¶5-760).
- (11) An exclusion clause may exclude liability for negligence if it is unequivocally expressed (¶4-240) so long as it is not covered by the statutes outlined in (8) and (9) above.

¶6-190 Binding effect of signed documents. Where a person has signed a document knowing it to contain contractual terms, in the absence of fraud that person is bound by its terms: it is immaterial whether the person signing reads the document or not.

— *Case example* —

The plaintiff bought an automatic vending machine from the defendant on terms contained in a document described as a sales agreement, and including a number of clauses in small print which she did not read. It was held that the plaintiff was bound by the terms in small print, whether she read them or not.³

— *L'Estrange v Graucob (F) Ltd*⁴ —

¶6-200 Vouchers, receipts and tickets are non-contractual. Terms can be incorporated into a contract from other places by being referred to in the contract. Newspaper classifieds lodged by the advertiser are usually subject to the publisher's terms and conditions set out in its “advertising rate card”.

Failure to notify a person before the contract is formed and to identify clearly what are really additional terms may have the effect of their being left out of the contract; therefore terms (including an exclusion clause) in what appears to be a non-contractual document like a voucher, receipt, ticket, manual, cheque book cover or advertising brochure may not be contractually binding.

3. In Victoria this principle has been overridden in the case of consumer transactions by the *Goods Act 1958* (Vic). Section 84(4) provides that “a person shall not be deemed to be aware of a fact ... by reason only that he has signed a document or writing stating that fact ...

or stating that he is aware of that fact, matter or circumstance”.

4. [1934] 2 KB 394; [1934] All ER Rep 16; Spencer, JR, *Signature, consent, and the rule in L'Estrange v Graucob* [1973] Cambridge Law Journal 104.

The clause was
misrepresentation

— Case examples —

Dry cleaning receipt. The plaintiff took to the defendant's dry cleaning shop a white satin dress trimmed with beads and sequins. A shop assistant gave her a document to sign headed "receipt". Upon asking about the document and being told it contained an exemption clause as to liability for damage to the sequins and beads, she signed it. It turned out that the clause in fact exempted the defendant from any damage to the dress whatsoever. The dress was stained in the dry cleaning process and the plaintiff sued. The court held for the plaintiff as the defendant's agent (the shop assistant) had misrepresented the effect of the document; the defendant had only agreed to run a risk as to the sequins and beads but not as to the dress itself. It was also held that in some circumstances where the document has been signed a court may draw the inference that the document was a mere receipt and not a contractual document. Thus terms in a document signed under a misapprehension as to its effect and nature may not be effective at common law to bind the party signing if the document appears to be a receipt only.

— *Curtis v Chemical Cleaning and Dyeing Co*⁵ —

Travel brochure. A passenger injured when a gun exploded during trap shooting entertainment on a holiday cruise in Greece was initially denied compensation by the shipowners under the ticket's exclusion clause. In fact, the ticket with the exclusion was issued in Greece in exchange for an "exchange order" issued in Australia, ie after the contract had been formed in Australia (¶6-220). The travel brochure available in Australia on Mediterranean cruises was held to be informative but not contractual, and although it referred to the ticket contract which "may be inspected at any Sun Life Office", its terms could not be incorporated into the Australian contract because there was no Sun Life Office in Australia.

— *Oceanic Sun Line Special Shipping Co Inc v Fay*⁶ —

If the document containing the purported exclusion clause is merely delivered to, rather than signed by, the other party, the question of that party's consent to the exclusion clause is raised.

— Case example —

The complainant's husband left a dress for dry cleaning with the defendant. The dress was returned stained and the plaintiff claimed damages. The defendant pleaded by way of defence an exemption clause printed on a docket given to the husband at the time of leaving the dress. In issue was the nature of the docket. *Herring* CJ held that the docket was one that might reasonably be understood to be only a receipt or voucher to enable the customer to get back his dry cleaning, and not a document containing

5. [1952] 1 KB 805 at p 808; [1951] 1 All ER 631 at p 633.

6. *Oceanic Sun Line Special Shipping Co Inc v Fay* (1988) 165 CLR 197; (1988) 62 ALJR 389: the Queensland passenger, Sydney travel agent, and ticket issued in Greece subject to the courts of Athens,

also raised the major issue of where the international contract was formed: eg Garner, M, *Formation of international contracts — finding the right choice of law rule* (1989) 63 ALJ 751. Cheque book cover held not to contain contractual terms: *Burnett v Westminster Bank Ltd* [1966] 1 QB 742, ¶16-200.

contractual terms exempting the defendants from their common law liability for negligence.

— *Causer v Browne*⁷ —

¶6-210 Notice of exclusion clause required. The nature of the document is important. If the document is not a receipt or mere voucher but a contractual document then its effectiveness may depend on notice. The issue is whether the customer was aware or should have been aware of the exemption clause.

— *Case example* —

The plaintiff (who was illiterate) had her niece purchase an excursion train ticket on her behalf. On the front of the ticket was a notice "Excursion. For conditions see back." On the back was a notice saying the conditions were printed in the railway company's timetables and excursion bills. The timetables cost sixpence each, and if the plaintiff had gone to the trouble of purchasing one she would have found that the conditions in the timetable exempted the company from liability for injury. The plaintiff was injured and unsuccessfully sued the company. The plaintiff could not rely on her illiteracy which was a burden and not a privilege. Further, she must have realised that as an excursion ticket was at a reduced rate there must have been special conditions attaching to its use. The court concluded that the plaintiff had received constructive notice of the exclusion clause. *Lawrence LJ* said that the company could not as a matter of ordinary practice draw attention, upon the ticket or verbally at the ticket office, to all the conditions which might become material according to the events which might afterwards happen.

— *Thompson v London, Midland & Scottish Railway Co*⁸ —

Indeed, any unusual conditions to be imposed by a contract must be clearly brought to the customer's notice in order to be effective.

— *Case example* —

A commercial contract for the hire of photographic transparencies included in the delivery note (separate from the contract and accompanying the items) a condition setting out details of a holding fee of £5 per day plus tax payable for non-return after the contract period. In the circumstances, the condition was held ineffective as it was not discussed and not brought to the attention of the customer. The fact that it was written into the delivery note was not fair, and the hiring company should have drawn the customer's attention specifically to the high price payable if the transparencies were not returned in time.

— *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*⁹ —

7. [1952] VLR 1. However, there may now be liability under the *Trade Practices Act 1974* (Cth) or State/Territory goods and services legislation for misleading or deceptive conduct (¶7-250ff) or for false representations (¶7-290ff).

8. [1930] 1 KB 41 at p 53; [1929] All ER Rep 474 at p 482.

9. [1988] 2 WLR 615; [1988] 1 All ER 348, noted (1989) 63 ALJ 431; ¶5-730.

Fair dealing is therefore expected of parties to the contract. If exclusion or penalty clauses are incorporated, especially where there is inequality of bargaining power, the courts may “rewrite” contracts under the law of unconscionability (§5-730—§5-760).

¶6-220 Notice given after contract formed is ineffective.

The cases mentioned in ¶6-210 must be read together with the well established principle that in any situation where the notice of an exclusion clause is given *after* the contract has been made, the notice will be ineffectual and the exclusion clause inoperative. For the exclusion clause to be incorporated into the contract, it must be brought to the other party’s attention *before* the contract is made.

— Case example —

The plaintiffs took a room at a hotel and paid a week’s board and residence in advance. When they went upstairs to their room, they found attached to the back of the door a notice to the effect that the management would not be held liable for the safety of articles left in the guests’ rooms. When the plaintiffs’ room was burgled, the defendants tried to rely on the clause. The Court of Appeal held that the clause could not be incorporated into the contract as the plaintiffs had no notice of it at the time they made the contract with the defendants at the front desk. Unless it was displayed at the reception desk or the like, it could not be added to the contract at a later time. *Denning* LJ said that persons who seek to rely on a contract to exempt themselves from their common law liability must prove that contract strictly and that nothing short of one or other of the following methods would suffice: (1) a written document signed by the party to be bound; (2) a written notice, specifying the terms, handed to the person to be bound before or at the time of the contract; and/or (3) a prominent public notice before or at the time of the contract.

*Olley v Marlborough Court Ltd*¹⁰

This decision might have been different had the plaintiffs been “regulars” at this hotel, in which case it could perhaps have been inferred that due to previous dealings they were in fact acquainted with the hotel’s rules (see ¶6-230). Thus they might have been deemed to have accepted them on a subsequent visit. Such a notice might also have been effective if the hotel management could have shown that such notices were uniform at all hotels and motels — or that the conditions were implied (§6-100ff) — and that all patrons therefore had constructive notice of what were in effect standard conditions.

Although many of the cases on exclusion clauses involve interpretation of the fine print on car parking tickets (ie contracts) to determine responsibility, it turns out that parking a car in a car park can involve many areas of business law:

10. [1949] 1 KB 532; [1949] 1 All ER 127.

(1) A car park may be liable under the *Trade Practices Act 1974* (Cth) and the *Fair Trading Act* of each State/Territory. In its assurances about security, etc has the car park engaged in misleading or deceptive conduct in breach of sec 52 (§7-250ff) or sec 55A (§7-415)? Has it made false representations in breach of sec 53 (§7-310)? Has its conduct been unconscionable (§5-730; §5-755—§5-760)?¹¹ Are its exclusions illegal under the Act (§7-370)?

(2) A car park may be liable for breach of contract. Express terms may be excluded, as in the following case.

— *Case example* —

The plaintiff parked his car in a garage that was automated. At the entry to the garage a ticket was dispensed by a machine and owners were referred to terms and conditions displayed on the pillars of the garage opposite the ticket machine: the notice exempted the owners from a number of things including liability for personal injury. The plaintiff sued the parking station for injuries received in an accident when he returned to collect his car. The court held, as with the hotel case, that as the contract was made before the ticket was dispensed from the machine, the terms, including the exclusion clause, were not incorporated into the contract, on the basis that the ticket was a mere voucher or receipt.

The court in *Thornton's case* attempted to state the proper test to be applied in the situation where a person is given a "ticket" on depositing goods with another party as in the parking station or dry cleaning instances: did the organisation do what was reasonably sufficient to give notice to its customers that the ticket contained an exclusion clause? Sufficient notice, not constructive notice, was again stated to be the true test. Lord *Denning* said:¹²

"We have been referred to the ticket cases of former times from *Parker v South Eastern Ry Co*^[13] to *McCutcheon v David MacBrayne Ltd*.^[14] ... In those cases the issue of the ticket was regarded as an offer by the company. If the customer took it and retained it without objection, his act was regarded as an acceptance of the offer: see *Watkins v Rymill*^[15] and *Thompson v London, Midland and Scottish Railway Co*.^[16] These cases were based on the theory that the customer, on being handed the ticket, could refuse it and decline to enter into a contract on those terms. ...

None of those cases has any application to a ticket which is issued by an automatic machine. The customer pays his money and gets a ticket. He cannot refuse it. He cannot get his money back. ... He was committed at the very moment when he put his money into the machine. The contract was concluded at that time. It can be translated into offer and acceptance in this way: the offer is made when the proprietor of the machine holds it out as being ready to receive the money. The acceptance takes place when the customer puts his money into the slot. The terms of the offer are contained in the notice placed on or near the machine stating what is offered for the

11. eg a long term parking lease with one-sided conditions.

12. [1971] 2 QB 163 at pp 169-170.

13. (1877) 2 CPD 416; [1874-80] All ER Rep 166.

14. [1964] 1 WLR 125; [1964] 1 All ER 430.

15. (1833) 10 QBD 178 at p 188.

16. [1930] 1 KB 41 at p 47; [1929] All ER Rep 474 at p 478.

money. The customer is bound by those terms as long as they are sufficiently brought to his notice beforehand, but not otherwise. He is not bound by the terms printed on the ticket if they differ from the notice, because the ticket comes too late. The contract has already been made: see *Olley v Marlborough Court Ltd*.^[17] ... In the present case the offer was contained in the notice at the entrance giving the charges for garaging and saying 'at owners risk', ie at the risk of the owner so far as damage to the car was concerned. The offer was accepted when [the plaintiff] drove up to the entrance and, by the movement of his car, turned the light from red to green, and the ticket was thrust at him. The contract was then concluded, and it could not be altered by any words printed on the ticket itself. In particular, it could not be altered so as to exempt the company from liability for personal injury due to their negligence ... It is no use telling the customer that the ticket is issued subject to some 'conditions' or other, without more: for he may reasonably regard 'conditions' in general as merely regulatory, and not as taking away his rights, unless the exempting condition is drawn specifically to his attention."

— *Thornton v Shoe Lane Parking Ltd*¹⁸ —

Implied terms of due care and skill may apply — at common law (§16-110), and under the *Trade Practices Act 1974* (Cth) and equivalent State/Territory legislation (§17-095).

(3) A car park may be liable in bailment. If possession has been transferred to the car park, is the car park liable as a bailee under a contract of bailment? If no possession has been transferred to the car park, the relationship is that of licence, with lower standards expected of the car park (§15-020).

(4) A car park may be liable in tort. Is the car park negligent as an occupier (§14-090)? Is the car park in breach of its duty of care to guard against theft? Is the car park liable in the tort of conversion (interference with the rights of the owner)?¹⁹

The principle that notice of an exclusion clause is ineffectual if given after the contract is made is equally applicable to other factual situations. Thus in a case involving a travel contract the New South Wales Court of Appeal approved Lord Denning's warning in *Thornton's case*. The High Court in this case, the *Baltic Shipping Company case*, confirmed that full damages and restitution (§16-510) will not be given for the same breach of contract.

— *Case example* —

Due to negligence of the pilot in taking the Russian cruise ship *Mikhail Lermontov* through a passage indicated on the navigation chart as "dangerous", the ship sank in New Zealand waters in 1986. Claims from 375 of the 410 passengers and staff surviving the shipwreck were settled by the shipping company, but Mrs P, despite having signed the company's "release from

17. [1949] 1 KB 532; [1949] 1 All ER 127.

18. [1971] 2 QB 163; [1971] 1 All ER 686.

19. eg Palmer, NE, *Bailment*, The Law Book Co Ltd, 2nd ed, 1991, pp 413-429;

Clarke, PH and Meagher, J, *Car parks and exclusion clauses* (1991) 65 LIJ 732.

further liability” form, pressed ahead for compensation for personal injuries and for loss of personal effects. Her claim was successful under modern legislation affecting contract and under the law of contract:

(1) The release form was “unjust” under sec 9(2)(a) of the *Contracts Review Act 1980* (NSW) ¶5-760 because of the “material inequality of bargaining power” between Mrs P and the shipping company. This was due to her vulnerability following recent widowhood and the circumstances of the shipwreck. (Mrs P, aged 53, had to jump two metres into a rescue boat in the dark ten minutes before the ship sank.) The release was also “unjust” due to the difference between the amount paid on the release (\$4,786) and her entitlement at law (\$51,396).

(2) The contract was made on 6 December 1985, when the balance of the fare was paid to the travel agent with the return of the booking form, but the ticket limiting the shipping company’s liability for personal injuries and personal effects was not issued until 24 January 1986. Therefore the limitation clauses in the ticket had not been brought to Mrs P’s attention and they did not form part of the contract. (Lord Denning’s warning in *Thornton’s case* quoted above was approved by the NSW Court of Appeal.)

(3) The trial judge found the shipping company’s conduct in procuring the release lacked bona fides and was misleading or deceptive under sec 52 of the *Trade Practices Act 1974* (Cth) (¶7-250). However, the NSW Court of Appeal did not consider the conduct misleading or deceptive as there was no evidence to prove reliance or alteration of position by Mrs P. There was also doubt whether sec 74 as it then read (implying non-excludable warranties into contracts for services: ¶7-095) would have covered an entire contract for transportation of a person (at that time, outside the Act) and for transportation of baggage (inside the Act). (Current sec 74 is now wider and could apply to losses from the carriage of Mrs P personally. The main current limitation of sec 74 is that it does not apply to contracts for transportation or storage of goods for a business customer or to contracts of insurance: ¶7-095.)

The signed settlement release for \$4,786 was declared void under the *Contracts Review Act 1980* (NSW). Damages of some \$50,000 were awarded as follows: compensation for disappointment and distress consequential upon physical inconvenience: ¶6-460 (\$5,000); loss of luggage and personal effects (\$4,265); physical injuries and nervous shock (with interest, \$45,500); less the \$4,786 already paid.

——— *Baltic Shipping Company “The Mikhail Lermontov” v Dillon*²⁰ —

This case is especially important as it again confirms that most contractual disputes now also involve the *Trade Practices Act* and other parallel State/Territory Fair Trading legislation dealing with misleading and deceptive conduct, false representations and unconscionability.

20. (1993) 176 CLR 344; (1993) 67 ALJR 228 on appeal from (1991) 22 NSWLR 1; noted at (1993) 67 ALJ 379; ¶5-400;

¶6-510. The High Court disallowed restitution of the balance of the fare (\$1,417).

¶6-230 Previous dealings may infer sufficient notice.

Previous dealings may lead to the inference that a person has received “sufficient” notice of exclusion clauses. However, previous dealings are relevant only if they prove knowledge of the terms, actual or constructive, or assent to them. If a term is not expressed in a contract it can only be imported by implication and no implication can be made against a party of a term which was unknown to that party.²¹ In the following case, involving an action for assault, false imprisonment and payment applicable to entry upon land, the High Court confirmed that if a person is aware of the terms, that person must be held to have agreed to them when entering the contract:

— Case examples —

Ferry fare. P was a regular passenger on the Sydney Harbour ferry running between Circular Quay and Balmain. On 5 June 1905 at 7.45 pm, he paid his one penny by dropping it into the turnstile and gaining admission to the wharf. Having just missed the ferry, he attempted to leave the wharf but was stopped by the attendants who drew his attention to a sign above the turnstiles which read: “Notice. A fare of one penny must be paid on entering or leaving the wharf. No exception will be made to this rule whether the passenger has travelled by ferry or not.” Objecting to paying one penny twice, he was detained by the attendants. P sued the ferry company for false imprisonment and assault, but the High Court held unanimously that, because of his previous use of the ferry, P knew the terms and conditions of entering the wharf at the time he put his penny into the turnstile to gain admission. The presence of the notice was not considered material to the decision.

In this case the court spoke of “sufficient” notice, not “constructive” notice, implying that the notice must actually be brought to the plaintiff’s attention. The requirement to do so was discharged because, first, the ferry company had placed the sign over the entrance to the wharf and, secondly, the plaintiff was a “regular” on the wharf — he had been there many times before — and the evidence showed that he did in fact know of the purpose of the turnstiles and the conditions of admittance.

— *Balmain New Ferry Co Ltd v Robertson*²² —

Shipyard’s “job card”. In contrast, the printed terms and conditions on a “job card” for a ship’s annual overhaul between the shipowner and a shipyard never operated contractually because they were not brought to the notice of the shipowner: “a notice on the outside of a building at a shipyard ... is not reasonable notice to any person intending to contract with the shipyard that ... [it] contracts on the basis of an exclusion of liability from all contractual or tortious default ... or, where the *Trade Practices Act 1974* (Cth) applies to the contract that the statutory limitation of liability provided in sec 68A of that Act is to be incorporated as a contractual term.”

— *Pondcil Pty Ltd v Tropical Reef Shipyard Pty Ltd*²³ —

21. *McCutcheon v David MacBrayne Ltd* [1964] 1 WLR 125, per Lord Devlin at pp 134-135.
22. (1906) 4 CLR 379; appeal dismissed under name *Robinson v Balmain New Ferry Co Ltd* [1910] AC 295 (PC).
23. (1994) ATPR (Digest) ¶46-134 at p 53,656 (¶7-012). Section 68A is set out in ¶7-170.

¶6-240 Interpretation of exclusion clauses. Assuming that an exclusion clause is incorporated into the contract (see ¶6-180—¶6-230), what exactly does the exclusion clause mean, and how is it to be interpreted? Because of the “take it or leave it” nature of so many exclusion clauses, the courts have often interpreted them in favour of the person upon whom the clause was forced.

There are at least three possible approaches to interpretation of an exclusion clause.

- (1) *The contra proferentem rule.* The law always takes the view that a person who drafts a document has to “live with” any ambiguities in its document: ambiguities are interpreted *contra proferentem* or against the interests of the person who drafted the document (considered also at ¶17-620).
- (2) *The “four corners rule”.* The “four corners” or “deviation” rule of interpretation states that an exclusion clause only covers a loss which occurs when a party is performing the contract (ie acting within the four corners of the contract). Exclusion clauses do not apply to actions outside the contract.

— *Case examples* —

The plaintiff left his car in the Sydney City Council’s Domain Car Park and was issued with a ticket which contained the “usual” conditions, one of which enabled the Council to avoid or deny liability for loss or damage to the vehicle, its contents or for any injury to third parties howsoever arising. A person who claimed to have lost his ticket was allowed to take the plaintiff’s car from the parking station even though the number of the vehicle given by the impostor did not match the number of the plaintiff’s vehicle. The plaintiff sued for damages in contract and in the tort of detinue (ie wrongful detention of goods) and claimed a return of the car or its value. A majority of the High Court held for the plaintiff on varying grounds. *Barwick* CJ and *Taylor* J held that the Council’s employee in handing over the vehicle to an unauthorised person had acted completely outside the terms of the contract of bailment (the safe-keeping contract: Chapter 15).

All of the members of the High Court took the point that the question was one of construction of the term in light of the particular facts of the case. Thus *Windeyer* J held that it was a breach of an express term of the contract not covered by the exclusion clause that “this ticket must be presented for time stamping and payment before taking delivery of the vehicle”. In treating the application of the Council’s exclusion clause as no more than a matter of construction, rather than as a substantive “rule of law”, the High Court anticipated the decision of the English House of Lords two years later in the *Suisse Atlantique* case (below) which finally and clearly overruled an automatic rule of “fundamental breach”. In fact, the majority of the High Court avoided discussing the rule beyond expressing difficulty in understanding exactly what it was supposed to mean.

— *Sydney City Council v West*²⁴ —

24. (1965) 114 CLR 481 at pp 488-490;
¶15-020.

Consignor P regularly employed Carrier D to transport its goods from Melbourne to Sydney, the practice being that D's subcontractor would collect the goods and deliver them to D's Melbourne depot for interstate transport. On the date in question, D's subcontractor arrived at the depot 10 minutes after closing time, so he left the goods on the truck and drove it home. There was a fire in his garage overnight, and the subcontractor's truck and P's goods were damaged.

P succeeded in its claim against D for compensation for the goods. D was in breach of contract, as the subcontractor's taking the goods home overnight was an unauthorised departure or deviation from D's contract even though there was no negligence by D or its subcontractor: D could not rely on the exclusion clause in the consignment contract limiting its liability. In line with the *Suisse Atlantique* case (below), the exclusion clause was therefore inapplicable to the breach of contract as a matter of construction.

*Thomas National Transport (Melbourne) Pty Ltd v
May & Baker (Australia) Pty Ltd*²⁵ —

The following points should also be noted in relation to the above case:

- If the subcontractor had been negligent, privity law might have prevented it from being protected by P and D's contract (¶6-265).
- In the absence of a contract between P and D's subcontractor, P could have claimed compensation from the subcontractor under the common law duties of a bailee if there had been evidence of negligence (¶15-070—¶15-080).
- The non-excludable warranties of due care and skill and fitness for purpose in contracts for services (*Trade Practices Act 1974* (Cth) sec 74(1) and (2): ¶7-095) do not apply to transport contracts for business purposes (sec 74(3)).

— *Case examples* —

An experienced skater was injured at a roller skating rink when he was thrown to the floor after his skate jammed in a piece of loose flooring. A sign at the entrance to the rink read "No responsibility is accepted by the management for any injuries to patrons. Skating is at the patrons' own risk, and is a condition of entry." These words were held not to exempt the defendant occupier from liability: if the two sentences were read together, the sign did not apply to all "injuries to patrons" however occurring, but only excluded liability for injuries connected to skating. It did not, in any case, apply to injuries which were due to a breach of a warranty on the state of the premises, even if in the course of skating.

*Bright v Sampson and Duncan Enterprises Pty Ltd*²⁶ —

When D's subcontractor misappropriated a load of scrap metal, P (the owner) succeeded in its claim for damages against D (the carrier) for breach of contract and conversion. As bailee, D was responsible for the loss (¶15-070ff), and the exception clause in the "conditions of cartage" in the cart note or "delivery docket" to protect D while the goods were "in transit or in

25. (1966) 115 CLR 353.

26. (1985) 1 NSWLR 346.

storage" was held inapplicable because the misappropriation did not occur during the "contractual journey": the goods were in transit or storage only for the subcontractor's dishonest purpose.

————— *Rick Cobby Haulage Pty Ltd v Simsmetal Pty Ltd*²⁷ ———

(3) *The exclusion clause is to be interpreted according to the express agreement (rejection of the former doctrine of fundamental breach).* The courts used to use the expression "fundamental breach" as a kind of consumer protection device to prevent a party in serious breach of its contract from relying on an exclusion clause in the contract. For example, when a buyer refused to accept delivery of a defective car, he successfully pleaded the poor physical condition of the vehicle when he was sued for breach of contract. It was held that the car delivered was not the car contracted for and the seller's exclusion clause provided no protection when the seller was not carrying out the contract in its essential respects.²⁸ In contrast to this, courts now take the view that, all things being equal, the parties should be held to their contract.

This "doctrine" of fundamental breach has been disapproved in Australia and in the UK, and in the view of Kirby J: "it is now desirable to expunge the suggested category designated by the 'shorthand' expression 'fundamental breach'".²⁹

The High Court in the *Sydney City Council* case (above) rejected the view that a breach of contract prevents reliance on an exclusion clause: the operation of an exclusion clause is a matter of construction. Similarly, the High Court in the following case has confirmed the earlier Australian cases such as that of the *Sydney City Council* to the effect that exclusion clauses and limitation clauses are to be construed according to their natural and ordinary meaning read in the light of the contract as a whole.

— *Case example* —

An investor incurred losses in dealings in commodity futures trading, partly due to the broker's acting beyond authority. In an action to recover compensation for the losses, the court held that the exclusion clause (cl 6) did not apply in the circumstances because it only applied to trading activity by the broker acting within the investor's authority. Although this clause did not exclude the broker's liability, the limitation clause (cl 7(c)) successfully limited liability to \$100 per transaction arising "out of or in connection with the relationship established by the agreement" even if, as in these circumstances, unauthorised.

————— *Darlington Futures Ltd v Delco Australia Pty Ltd*³⁰ ———

27. (1986) 43 SASR 533.

28. *Karsales (Harrow) Ltd v Wallis* [1956] 2 All ER 866.

29. *J & C Reid Pty Ltd v Abau Holdings Pty Ltd*, (1988) NSW ConvR ¶55-416, noted (1988) 62 ALJ 1053.

30. (1986) 161 CLR 500, noted (1987) 50 MLR 952, Australian Accountant, Vol 58, No 4, p 21 (May 1988).

"In commercial dealings between parties negotiating at arm's length in their own interests one must guard against being too ready to discover such a special relationship [of reliance between parties: ¶4-250] and to impose thereby obligations which would be quite contrary to ordinary commercial expectations."³¹

To the same effect, the House of Lords in the *Suisse Atlantique case*³² confirmed that the operation of an exclusion clause is no more than a matter of construction. Where there was delay in the loading of a ship, a demurrage or agreed damages clause which provided damages of £x was enforced over the actual loss of £2x. Had there been any doctrine of fundamental breach, the contract would have failed (including its demurrage clause) and the actual loss of £2x would have been awarded.

AMBIT OF THE CONTRACT

Privity of contract	¶6-260
Exclusion clauses and third parties	¶6-265
Exceptions to the doctrine of privity	¶6-270
Assignment of contractual rights and obligations	¶6-275

¶6-260 Privity of contract. Under the privity rule:

- (1) only a party to the contract gains rights under the contract, and
- (2) the contract only imposes obligations on the parties to the contract.

If A contracts with B to pay a monthly amount to intended beneficiary C, and if A defaults in payment to C, C cannot sue A. C is a stranger to the contract who has given no consideration for A's promise to B in the A/B contract.

— Case example —

A coal merchant, A, agreed to sell his business to his nephew, B, in consideration of B agreeing to employ A as a consultant at £6.10s a week for the rest of his life and, after his death, continuing to pay £5 per week to A's widow, C. C was not a party to the contract and had not signed anything, even though she was a beneficiary under the contract. A died on 3 November. B paid C one sum of £5 and then no more. C sought an order for specific performance of the agreement in two capacities: (1) as administratrix of A's estate and (2) in her personal capacity. Clearly (2) would fail because C was not a party to the contract, but under (1) C succeeded because she was not suing as C but on behalf of A, a party to the contract.

— *Beswick v Beswick*³³ —

31. *Halton Pty Ltd v Stewart Bros Drilling Contractors Pty Ltd* (1992) ATPR ¶41-158 at p 40,153 (Supreme Court of NSW).

Centrale [1967] 1 AC 361; [1966] 2 All ER 61.

33. [1968] AC 58.

32. *Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen*

The privity doctrine therefore would have defeated the purpose for which A and B had contracted (to benefit C), and denied C the right to enforce directly the contract intended for C's benefit.

If A's promise had been made to B and C jointly as joint promisees, or if it had been supported by consideration given by B and C, A's promise would be enforceable by B and/or C:

— *Case example* —

A made a promise to B and C jointly that A would make certain payments to them in consideration of B's promise to A. C provided no consideration to support A's promise. The High Court held that the promise was made to B and C jointly or collectively, and that it was supported by consideration. The consideration need not be given by B and C separately, and the promise was therefore enforceable by C alone.

— *Coull's v Bagot's Executor and Trustee Co Ltd*³⁴ —

Only through one of the exceptions to the privity rule could C enforce an A/B contract if C was not a party to the contract (§6-265).³⁵

The privity rule has been criticised. For example, the *Trident Insurance case* (facts set out at §6-270) recognised these criticisms of the privity rule. This case was technically a decision on whether beneficiary C could claim on B's contract of liability insurance between insurer A and insured B (held, yes), the judges recognised that the decision would be generalised (§1-380), that it would "have implications for privity of contract in other situations" and that the decision "inevitably takes the Court into areas that lie outside the field of insurance".

§6-265 Exclusion clauses and third parties. The qualified restriction of the doctrine of privity will affect the operation of exclusion clauses in the A/B contract and the extent to which they can protect third party C. The doctrine of privity had denied the right of C to sue upon the A/B contract as "stranger" to the consideration.

— *Case example* —

When a case of goods being shipped under a contract for the carriage of goods by sea was damaged by stevedore C, it was held that C's liability was not limited under the contract between A (the carrier) and B (the consignor) contained in a bill of lading because the benefit of the contract existed for A/B exclusively and that C, as stranger to the contract, was not entitled to the exemption conferred (§15-060).

— *Wilson v Darling Island Stevedoring & Lighterage Co Ltd*³⁶ —

34. (1966-67) 119 CLR 460.

35. Through exceptions to the doctrine of privity (§6-270). American law has for some time allowed third party enforcement, eg consumer C to bypass retailer B to sue manufacturer A: eg

Professional Lens Plan, Inc v Polaris Leasing Corporation 675 P 2d 887 (1984) (defective computer).

36. (1956) 95 CLR 43. Similarly, *Scruttons Ltd v Midland Silicones Ltd* [1962] AC 446.

Although this case and its principle were not expressly overruled in the *Trident Insurance* case (set out at ¶6-270, and see ¶6-260),³⁷ the narrow holding or ratio of *Trident* would allow third party C to sue where “[A] issues a [contract], identifying [B] in terms that evidence an intention on the part of both [A] and [B] that the [contract] will indemnify as well those with whom [B] contracts for the purpose of the venture covered by the [contract] [ie persons C]”.³⁸

However, until the decision is confirmed in this context, pre-existing case law would allow third party C to obtain a benefit (such as that under an exclusion or limitation of liability clause) under the A/B contract by various means such as:

- (1) Implication of a contract between B and C incorporating the terms (and exclusions) of the A/B contract (cf ¶6-100ff).
- (2) Insertion of an exclusion clause in the A/B contract containing an express promise by A to B not to sue C.
- (3) Insertion of a clause in the A/B contract ensuring that A pay to B any sum which A might recover from C.
- (4) Reliance on the law of agency. Australian law now accepts exclusion of liability for C if the prerequisites for the validity of an agency contract listed by Lord Reid in the *Midland Silicones* case are satisfied:³⁹

“I can see a possibility of success of the agency argument if (first) the bill of lading makes it clear that the stevedore is intended to be protected by the provisions in it which limit liability, (secondly) the bill of lading makes it clear that the carrier, in addition to contracting for these provisions on his own behalf, is also contracting as agent for the stevedore that these provisions should apply to the stevedore, (thirdly) the carrier has authority from the stevedore to do that, or perhaps later ratification by the stevedore would suffice, and (fourthly) that any difficulties about consideration moving from the stevedore were overcome.”

— Case example —

When a load of chocolate being carried from Sydney to Brisbane was damaged by overheating, it was held that liability of C (the owner of the prime mover) was limited by the contract of carriage between A (Life Savers, the owner of the chocolate) and B (the carrier) because C satisfied the aforementioned four tests and was able to obtain the contractual immunity of B. Established connection between B and C was held not to be essential because when C accepted the goods for delivery, C’s acceptance was under a contract drawn so as to appear to provide protection to C; C should be

37. *Trident General Insurance* case (1988) 165 CLR 107. *Wilson’s* case was not overruled in *Trident*, although its authority has certainly been undermined.

38. *Ibid*, per Toobey J at CLR p 172, with “[contract]” substituted for “liability insurance policy”.

39. *Scruttons Ltd v Midland Silicones Ltd* [1962] AC 446 at p 474; [1962] 1 All ER 1 at p 10.

taken to be accepting the goods on those terms, and B should be taken to be making an offer to C direct.

_____ *Life Savers (Australasia) Ltd v Frigmobile Pty Ltd*⁴⁰ —

“*Himalaya clause*”. If it fulfils the four tests in the *Midland Silicones case*, a “*Himalaya clause*” — a third party exemption clause in a bill of lading — gives the same defences and immunities of carrier B to third person C if C is a servant or agent of carrier B (including every independent contractor employed by carrier C).⁴¹ In other words, as against A, the sub-bailee C may be able to take advantage of the terms on which the goods have been bailed by A to B. For example, in the *Salmond & Spraggon case* a Himalaya clause in the A/B contract protected stevedores (C) who had breached their duty when they allowed goods which had been unloaded from a ship to be delivered to the wrong persons.⁴²

¶6-270 Exceptions to the doctrine of privity. The following situations where the doctrine of privity is not relevant exist in the common law, equity and statute:

- (1) *Agency*. In agency law, a person who has taken no part in the making of a contract, and who may not even be named in it, can sue and be sued on the contract as undisclosed principal if it can be shown that the party making the contract was acting as the person’s agent. This is discussed at ¶11-340—¶11-350.
- (2) *Land law*. Certain land contracts are able to create obligations which may bind third parties:
 - (a) *Leases*. In the case of leases, if lessee B assigns the lease to lessee C with A’s consent, the original lessor A may remain liable to lessee C (the assignee) in respect of covenants in the A/B lease affecting the land.
 - (b) *Covenants affecting land*. The vendor of land (A) may be able to restrain a later purchaser (C) from breaching a restrictive covenant in the contract between A and the original purchaser B. The

40. *Life Savers (Australasia) Ltd v Frigmobile Pty Ltd* [1983] 1 NSWLR 431; Cavanagh, SW, *The ultimate exclusion clause* (1985) 59 ALJ 67.

41. Named after *Adler v Dickson* [1955] 1 QB 158. P & O’s SS *Himalaya* was berthed at Trieste at the time of the accident.

42. *Port Jackson Stevedoring Pty Ltd v Salmond & Spraggon (Australia) Pty Ltd (The New York Star)* (1980) 144 CLR 300 which applied *New Zealand Shipping Co Ltd v AM Satterthwaite & Co Ltd (The Eurymedon)* [1975] AC 154; Malcolm, Chief Justice D, *The negligent pilot and the Himalaya clause: a saga of disagreement* (1993) 67 ALJ 14.

assignee of a lease (C) from the original lessee (B) may be able to enforce the original A/B lease against A.

- (3) *Agreements affecting land.* Land law legislation provides that third parties may enforce an agreement if expressed in their favour.⁴³

“Persons taking who are not parties. 36c(1) A person may take an immediate or other interest in land or other property, or the benefit of any condition, right of entry, covenant, or agreement over or respecting land or other property, although he may not be named as a party to the assurance or other instrument.

36c(2) Such person may sue, and shall be entitled to all rights and remedies in respect thereof as if he had been named as a party to the assurance or other instrument.”

Case law has interpreted this narrowly, and this law has been modified in Queensland and Western Australia ((4) below).

- (4) *Property Law Act exceptions.* Property Law Acts in Queensland and Western Australia provide in certain circumstances that a person who is given a benefit under a contract may enforce the contract although not a party to it.¹ Such statutes provide that a person can take an interest or benefit of any agreement in land or other property even though that person is not named as a party to the conveyance or other instrument. This remedies the situation which occurred in *Coulls’ case* (§16-260).²

— *Case example* —

An agent was able to sue on a contract for the purchase price (to allow deduction of agent’s commission) between the principal and the third party because the contract conferred a benefit on the agent within the legislation and was thus enforceable even though the agent was not a party to the contract and had provided no consideration.

————— *Westralian Farmers Co-operative Ltd v Southern Meat Packers Ltd*³ —

- (5) *Bills of exchange, cheques, and promissory notes.* These can be sued upon by parties who were not the original parties so long as there has been a valid negotiation to the new parties (§16-260). A cheque drawn by A payable to B, which B transfers to C, who indorses it to D, can be sued on by D if it is dishonoured by A.

43. *Conveyancing Act, 1919* (NSW) sec 36c; *Property Law Act 1958* (Vic) sec 56; *Property Law Act 1974* (Qld) sec 13; *Law of Property Act 1936* (SA) sec 34; *Property Law Act 1969* (WA) sec 11(1); *Conveyancing and Law of Property Act 1884* (Tas) sec 61; *Conveyancing Act 1951* (ACT).

1. *Property Law Act 1974* (Qld) sec 55; *Property Law Act 1969* (WA) sec 11(2)

and (3). Qld sec 55 was applied in *Re Davies* [1989] 1 Qd R 48, noted by Butler, DA, *Privity of contract in Queensland: recent developments* (1990) 10 Qld Lawyer 147.

2. *Coulls v Bagot’s Executor and Trustee Co Ltd* (1966-1967) 119 CLR 460.

3. [1981] WAR 241; *Charles Philippe Louis Nilant v Plexipack Packaging Services Pty Ltd* (1996) 14 ACLC 1,559.

- (6) *Documentary letters of credit.* When a buyer (usually an overseas buyer) arranges for a bank to make payment for goods, the contract is between the bank and its customer, the buyer. But once the bank informs the seller that an irrevocable credit has been opened, the bank in effect promises to pay the seller on receipt of the relevant shipping documents.
- (7) *Trusts of contractual rights.* Where A makes a promise to B for the benefit of C, C can enforce the promise through the law of trusts if promisee B has become a trustee of A's promise for the benefit of C.⁴ However, the intention to constitute a trust must be clearly proved. Intention to create a trust would be satisfied by the terms of a contract which expressly or impliedly indicate that intention as the joint intention of A and B. Hence, the effect of C becoming a designated contractor or subcontractor in line with A's insurance policy issued to B in the *Trident Insurance case* (see case example below) was to create a trust for C of the benefit of A's promise to indemnify C against the insured loss.
- (8) *Trusts.* The doctrine of privity does not prevent the manager or trustee of a trust from enforcing the equitable obligations in a trust deed (§9-820).
- (9) *Novation.* Novation is a three-party agreement where a contract between A and B is discharged and replaced with a new contract between A and C. The new contract usually has the same terms, but with the new party C instead of B. Novation is intended to release B from the A/B contract. Novation is different from assignment (§6-275) because assignment is between two parties only (A and B), whereas novation requires the agreement of the three parties A, B and C.

— *Examples: novation* —

- A retiring partner's liability can be discharged by agreement with the creditors: §10-360.
 - Futures contracts entered on the trading floor of the futures exchange are registered with the clearing house.⁵ This means that each contract is novated to the clearing house. The clearing house guarantees performance of the contract because of the novation of the contract — the clearing house becomes the buyer to every seller and the seller to every buyer of a registered contract.
-

- (10) *Other statutory exceptions to the doctrine of privity*, such as:

- *Corporations Law* sec 1324 — which allows a “third party” to apply for an injunction (§8-810) in certain circumstances;

4. *Wilson v Darling Island Stevedoring and Lighterage Co Ltd* (1956) 95 CLR 43 at p 67; Wright, D, *Trusts involving enforceable promises* (1996) 70 ALJ 911.

5. The Sydney Futures Exchange Clearing House Pty Ltd is the clearing house for the Sydney Futures Exchange.

- Consumer laws which provide that the consumer in a consumer/retailer contract can sue the third party manufacturer.⁶ There may also be a remedy available under sec 52 or 53 of the *Trade Practices Act 1974* (Cth) to a third party beneficiary.⁷
- *Insurance Contracts Act 1984* (Cth) sec 48. Where insurer A issues a liability insurance policy to B and both A and B intend the policy also to indemnify subcontractors C1, C2, etc with whom B contracts for the purpose of the insured venture, C can sue A on the policy even though consideration may have not moved from C to A, and even though C is not a party to the A/B contract (§17-230).

— Case example —

C was the principal contractor for construction work at B's limestone crushing plant. For insurance protection, B had taken out a contract of indemnity insurance with insurer A over the contract works, liability to the public and maintenance/defects liability in a policy which defined the insured as "(B), all its subsidiaries, associated and related companies, all contractors and subcontractors and/or suppliers", ie B, C1, C2, etc. When subcontractor C2 (a crane driver) recovered some \$540,000 damages from C1 for an injury negligently caused by C1, C1 claimed indemnity as one of the insured under B's policy with insurer A. According to the legal doctrine of privity of contract (§6-260), A could deny liability because C2 (and C1) was not a party to the A/B contract. Such a rule would have been obviously unjust in these circumstances, and the High Court went around the privity doctrine in allowing C's claim against A because the privity doctrine clashed with the "legitimate expectations" and the expressed intention of all the parties to the insurance contract. The actual ratio of the decision is set out in the words of *Toohy J*:

"When an insurer issues a liability insurance policy, identifying the assured in terms that evidence an intention on the part of both insurer and assured that the policy will indemnify as well those with whom the assured contracts for the purpose of the venture covered by the policy, and it is reasonable to expect that such a contractor may order its affairs by reference to the existence of the policy, the contractor may sue the insurer on the policy, notwithstanding that consideration may not have moved from the contractor to the insurer and notwithstanding that the contractor is not a party to the contract between the insurer and assured."

— *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*⁸ —

6. eg *Trade Practices Act 1974* (Cth) Pt V Div 2A (§7-012); *Sale of Goods Act 1923* (NSW) sec 64(5); §7-212.

7. Stewart, IB, *Why place trust in a promise?: Privity of contract and enforcement of contracts by third party beneficiaries* (1999) 73 ALJ 354 at p 363.

8. (1988) 165 CLR 107, noted, eg, (1990) 10 Qld Lawyer 147; Kincaid, P, *Privity*

and private justice in contract (1997) 12 JCL 47. Sec 48 of the *Insurance Contracts Act 1984* (Cth) allows a third party beneficiary of an insurance policy to sue on the contract. In the *Trident* case the contract preceded the commencement of the Act, so sec 48 could not apply (§17-230).

Although not overturning the doctrine of privity, the majority judges realised that their decision would have important implications for contract law. The fourth majority judge approached the decision on the grounds of unjust enrichment: in the opinion of *Gaudron J*, because insurer A received the agreed consideration from insured B for a promise to benefit third party C, A must fulfil its promise to C as agreed. *Gaudron J* upheld C's claim on the basis of restitution (¶6-510) to prevent unjust enrichment by A.

Decisions since the *Trident* case have confirmed that absence of privity prevents a third party beneficiary from suing at common law, but have converted an intention to benefit a third party by contract into an intention to create a trust.

- *Trade Practices Act 1974* (Cth). The absence of privity of contract between P and D is no barrier to a claim under the *Trade Practices Act* for misleading or deceptive conduct (¶7-250ff), false or misleading representations (¶7-290ff) or unconscionability (¶5-755).

- (11) A contractual relationship is not needed for a claim for unconscionable conduct at common law (¶5-730).
- (12) Privity of contract is not relevant for a claim in negligence (¶4-060).

¶6-275 Assignment of contractual rights and obligations.

An assignment is a transfer of ownership — it is the voluntary transfer of rights and obligations by one party to a contract to another person. As such, assignment is an exception to the privity rule.

As discussed at ¶3-040, a contract is a “legal chose in action”. The common law does not recognise that a right under a contract can be assigned, so a contract cannot be assigned at common law.

Assignment of contract can be considered under two headings:

- (1) *Assignment in equity*. A contract can be assigned in equity if the assignor has done all that is necessary, and equity will allow the assignee to enforce the assignment against the assignor. To be valid, equity requires no particular form — the assignment can be oral, consideration is not necessary and the assignee takes subject to equities (¶13-340). Equity prefers that notice has been given to the assignee.
- (2) *Assignment under statute*. As set out at ¶13-340, conveyancing and property law legislation provides for assignment of a legal or an equitable chose in action. (Equitable choses in action can still be assigned in equity.)

Certain contracts cannot be assigned:

- (1) The contract itself may forbid assignment.
- (2) A contract involving contractual rights of a personal nature including contracts for personal services cannot be assigned because the promisee (assignee) cannot be forced to accept performance from anyone other than

the promisor (assignor) and the promisee may gain benefits different from those contracted for. For example, an intended assignment from an individual to a company may be ineffective for this reason.

A contract with no personal element can be assigned, such as a contract to deliver parcels from Sydney to Canberra. The carrier may engage another person to deliver the parcels unless the contract involves some special skill of the carrier.

(3) A bare right of action to sue cannot be assigned to a person not connected to the litigation, unless the assignee has a proprietary interest in the litigation.

THE END OF THE CONTRACT

The meaning of “discharge”	¶6-280
Discharge by performance	¶6-290
Exceptions to the rule of precise performance	¶6-300
Discharge by agreement	¶6-310
Discharge by breach	¶6-320
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Discharge by operation of law	¶6-340
Discharge by frustration	¶6-350
Statutory reform of the doctrine of frustration	¶6-370

¶6-280 The meaning of “discharge”. Discharge of contract means no more than the conclusion or termination of the contract. Discharge takes place in various ways, according to what exactly the parties have done: discharge by performance, discharge by agreement, discharge by frustration and discharge by breach. Each is a different path leading to the same result, the ending of the contract and its obligations.

Sometimes the word “rescission” is loosely used to mean the rightful termination by a person faced with a breach of condition or the repudiation of a contract not performed (¶6-320). Technically, however, rescission refers to the situation where the courts will restore the parties to the positions they occupied before the transaction took place. Rescission may be granted because of mistake (¶5-620), misrepresentation (¶5-700), undue influence (¶5-710), duress (¶5-720) or unconscionability (¶5-730).

¶6-290 Discharge by performance. The usual manner in which a contract is brought to an end is when each party has performed the obligations imposed by the contract. The rule is that contractual obligations must be performed exactly, and usually near enough is not good enough. So, if tinned fruit is contracted to be delivered in boxes of 30, and is delivered instead in boxes of 24, even though the total is the correct quantity, the buyer will be entitled to refuse acceptance and to reject the goods on the

basis of the seller's defective performance.⁹ Because the seller has not completely and precisely performed the exact thing contracted for, the seller's obligations under the contract have not been discharged.

This means that the seller's obligations have only been partially fulfilled, and until there has been complete fulfilment, the seller is not generally entitled to recover for what has been done or supplied.

— *Case example* —

A builder contracted to build two houses for £565 (in 1898). Facing liquidity problems, the builder informed the owner that he could not continue, and claimed the balance owing of £333 for work to date. The builder's claim was unsuccessful — the contract was a lump sum or an entire contract, and its price could not be recovered until the work was done. The builder could not claim for part payment (1) under a *quantum meruit* — a pro rata payment (§6-510) — as the owner was not responsible for the builder's failure to complete, nor (2) for part performance, because there was (a) no evidence of agreement by the owner to part performance (§6-300) and (b) no agreement by the owner to termination of the contract at this stage.

— *Sumpter v Hedges*¹⁰ —

Performance of the contract must take place in the time specified, or by an implied term within a reasonable time if no time is specified. If performance at a certain time is essential to the parties, they may expressly insert a "time of the essence" clause in the contract as a condition or as a warranty (§6-050). Such a term could only usually be implied in commercial contracts as a matter of construction of the contract if it would fulfil the intention of the parties (§6-100).

If time is not of the essence, serving a notice to complete fixes the time for performance of the contract so that non-compliance evidences a breach of contract if the time fixed is reasonable and therefore valid.¹¹ The effect of the notice is to convert a non-essential term into an essential term to provide a basis for proof of repudiation of the contract.

§6-300 Exceptions to the rule of precise performance. This rule of precise performance must be read subject to its exceptions, which help to provide recovery for performance which has not been exact and precise.

(1) *Where contract is divisible.* If payment is due under the contract from time to time for performance of specified parts of the contract, the contract is divisible into its component parts. How does one tell the difference between an entire contract and a divisible or severable contract? The presumption is that a contract is divisible unless it is made as a whole; even then it may be difficult to work out the difference. If A employs B to paint A's house of 10

9. *In re Moore & Co and Landauer & Co* [1921] 2 KB 519 (§7-060).

10. [1898] 1 QB 673.

11. eg 13 days' notice to complete held insufficient in the circumstances: *Sindel v Georgiou* (1984) 154 CLR 661.

rooms for \$1,000, can B recover \$600 after six rooms are painted? If the contract provides for, say, "\$100 per room, payable on completion", pro rata recovery would be clear. If it does not so provide, or if such a provision could not be inferred, an outcome like that in the building case of *Sumpter v Hedges* referred to above (¶6-290) may be the result. The sale of goods legislation also provides that if the contract is to be delivered by stated instalments which are to be separately paid for, the terms of the contract and the circumstances of the case will determine whether the breach of contract is a repudiation of the whole contract, or whether the breach is severable giving rise to a claim for compensation.¹²

(2) *Where partial performance has been accepted.* As referred to above, an implied promise to pay for partial performance will be possible only where it can be inferred from all the circumstances. If the houseowner has accepted the builder's non-completion of the house, the court may infer a promise to pay for the benefit received and allow a *quantum meruit*. The principle of part performance is available to allow a contract which does not comply with the requirement under the *Statute of Frauds* equivalents to be enforced in equity: ¶5-030.

(3) *Where performance is prevented by the other party.* Where A is prepared to perform A's part of the contract, but is prevented from so doing by the other party B, A can sue B for damages for breach of contract. Alternatively, A could repudiate the contract as well, or repudiate and sue for damages, or A could sue for reasonable remuneration on the basis of a *quantum meruit* (¶6-510).¹³

(4) *Where there has been substantial performance.* It would be clearly unjust if the court did not allow recovery where there was only a slight difference between work actually done and what was contracted for. Allowance of recovery in these circumstances has been formalised as the doctrine of substantial performance,¹⁴ such that the slight difference cannot be raised to prevent a valid claim. Whether entire performance is a condition precedent to payment is a matter of interpretation. For example, if the contract provides for progress payments, the contractor is only entitled to payment pro rata as the contract proceeds. But even in lump sum contracts, the courts lean against a construction of the contract which would deprive the contractor of any payment and accept that payment is due on "substantial completion" (even if there are some defects or omissions. These can be cross-claimed or raised in diminution of the price).¹⁵

12. *Goods Act 1958* (Vic) sec 38(2); *Sale of Goods Act 1923* (NSW) sec 34(2); *1896* (Qld) sec 33(2); *1895* (SA) sec 31(2); *1895* (WA) sec 31(2); *1896* (Tas) sec 36(2); *1954* (ACT) sec 35(2); *1972* (NT) sec 34(2).

13. *Planche v Colburn* (1831) 8 Bing 14; 131 ER 305.

14. *Boone v Eyre* (1779) 1 Hy Bl 273n; 126 ER 160, per Lord Mansfield.

15. eg *Williams v Roffey Bros & Nicholls (Contractors) Ltd* [1990] 1 All ER 512 (¶15-470).

¶6-310 Discharge by agreement

(1) *Substituted agreement.* In the same way that a contract is the result of agreement, so it can be terminated by another agreement between the parties. But as any promise needs consideration from the other side to be enforceable, so will an agreement to discharge liability under a contract need consideration before it will be a legally enforceable agreement. If the contract is executory — ie a promise for a promise — then the respective promises by each party to release the other from liability are consideration for the discharge. This is called bilateral discharge.

(2) *Accord and satisfaction.* A person under contract may cancel the original contract by purchasing release from it by entering a new agreement (“accord”) for valuable consideration (“satisfaction”). For example, a cheque posted by a debtor to a creditor “in full and final settlement of all claims” would only be binding if the creditor so agreed.¹⁶

If the contract has been executed (completely performed by one party) then the party to be released must provide consideration or an equivalent to make it legally enforceable, namely, it must be under seal in a deed or it must be subject to the *High Trees and Walton v Maher* principle of promissory estoppel (see ¶5-485). This form of discharge is called unilateral discharge because when A agrees to release B from B’s contractual obligation, B can offer no consideration to bind A’s promise of release. Hence there must be *accord and satisfaction*, ie the agreement of A supported by the necessary consideration of B, with the agreement to discharge called the accord and the new consideration being the satisfaction. The facts of *Foakes v Beer* discussed at ¶5-480 illustrate the problems if such an agreement is made without consideration.

(3) *Failure of condition precedent or condition subsequent.* A contract may also provide for its own discharge, when, for example, it is dependent on the fulfilment of a condition precedent: I will buy your car if it passes a mechanical inspection; I will buy your house if it passes a pest inspection. If either fails, and depending on the analysis of the condition precedent (¶6-060), either (1) no contract comes into existence or (2) a condition which is precedent to the obligation of a party to perform its part of the contract is not fulfilled. The same applies if a contract provides for discharge by the occurrence or non-occurrence of a subsequent event under a condition subsequent: ¶6-070. For example, a promoter’s contract, made by persons on behalf of a company not yet incorporated, may provide for discharge of the contract if the company is not incorporated at all or is not incorporated within a reasonable time.

(4) *Election to terminate.* A contract may contain a clause giving a person an election to terminate the contract.

16. eg *McMahon’s (Transport) Pty Ltd v Ebbage* [1999] 1 Qd R 185; no evidence of agreement: ¶5-310.

(5) *Abandonment*. By agreeing not to proceed with a contract, the parties may be taken to have abandoned it. Abandonment may infer the implied consent of the parties to cancel the contract.

(6) *Waiver*. One person may waive performance of the contract by not insisting on strict performance. For example, a person may ask for an extension of time in a delivery contract: the other person's waiver of the exact delivery date is not contractual unless supported by consideration. However, in the absence of consideration, the person voluntarily waiving rights may be estopped from going back on the promise by the principle of promissory estoppel (§5-485).

In contrast to the creation or the modification of a contract, the *Statute of Frauds* and the parol evidence rule do not apply to the cancellation of a contract (cf §5-030).

¶6-320 Discharge by breach. Breach of contract by one party alters the innocent party's obligations under the contract. Total breach of contract, where one party does not perform the contract at all (ie breach of condition), gives the innocent party the right to regard the contract as finished. Partial breach, where one party does not perform the full requirements of the contract, gives the innocent party the right to sue for damages for breach of a warranty of the contract but does not entitle the innocent party to treat the contract as at an end (§6-050).

Breach of contract — whether total or partial — may come about in different ways such as:

- (1) clear failure to perform, or
- (2) express repudiation by one party's communicating its intention not to perform under the contract, or
- (3) an action of one party making performance impossible (such as the goods in question having been sold already).

Breach of contract may involve actual breach (actual failure to perform) or anticipatory breach (threatened breach).

Anticipatory breach. Any breach which takes place before the actual time for performance of the contract is called anticipatory breach. Anticipatory breach refers to a breach of contract where one party states or implies an intention not to do what is required under the contract. Anticipatory breach takes one of two forms — unwillingness or inability to perform — such that the injured party can anticipate the inevitable breach due to the other party being “wholly and finally disabled from performing its contractual obligations when the time for performance ... should arrive.”¹⁷

17. *Sunbird Plaza Pty Ltd v Maloney* (1988)
166 CLR 245 at p 280.

— *Case example* —

D engaged P as a courier in April, with the appointment to take effect on 1 June. Three weeks before commencement, D informed P that P's services were no longer required. This was clear anticipatory breach entitling P to damages for breach of contract, because D had indicated his intention to be no longer bound by his contractual obligations.

*Hochster v De la Tour*¹⁸ —

In the event of anticipatory breach, the innocent party can try to enforce the appropriate remedy immediately (¶6-380ff) or can ignore the breach and take action at the time for performance.

— *Case examples* —

Ten months after the agreement had been made, the lessor had still not registered the lessee's lease or delivered a registrable copy. Fourteen days' notice by the lessee to complete was not complied with, so the lessee terminated the lease on the basis that the contract had been discharged by repudiation: the lessor's intention was only to perform the contract in a manner substantially inconsistent with its obligations, such as would allow the lessee to treat the lessor as having repudiated the contract. The implied promise to secure registration of the lease was a condition essential to the contract because the lessee would not have entered into the contract unless assured of its substantial performance.¹⁹

*Laurinda Pty Ltd v Capalaba Park Shopping Centre Pty Ltd*²⁰ —

Two days before settlement date, the vendors' solicitor advised that settlement would have to be postponed, because the right of way required under the contract was not yet registered due to problems with the neighbours. Time was of the essence in the contract, and the purchaser signed a notice of rescission on the settlement date (rather than on the anticipatory breach two days earlier). Even though the purchasers failed to tender performance and were not ready to complete on the date of settlement, the High Court put the blame on the vendor: the vendor's failure to complete on the due date entitled the purchasers to rescind for repudiation or anticipatory breach on the vendor's part. The vendors' intimation (through their solicitor) of non-performance of an essential term of the contract amounted to repudiation and freed the purchasers from their performance of their dependent obligations even though they did not rescind the contract at that time. The purchasers were therefore entitled to recover their deposit as money paid for a consideration that had wholly failed.

*Foran v Wight*²¹ —

18. (1853) 2 E & B 678; 118 ER 922.

19. ie it was a condition not a warranty (¶6-090), citing the language of *Tramways Advertising Pty Ltd v Luna Park (NSW) Ltd* (1938) 38 SR (NSW) 632 at pp 641-642; ¶6-050.

20. (1989) 166 CLR 623, noted (1989) 63 ALJ 773.

21. (1989) 168 CLR 385, noted (1990) 64 ALJ 287.

Damages recoverable may be limited, as illustrated by the following cases.

— *Case examples* —

The charterer of the *Mihalis Angelos* repudiated the charter before the date on which the cancellation clause of the charter would have entitled it to do so, because of breach by the shipowners of a condition of the contract that the ship would be ready to load by the agreed date. Because only the true value of contractual rights can be compensated, damages which would have been awarded to the shipowners for breach of condition were reduced to nil because of the certainty of the charterer's cancellation under the cancellation clause.

— *The Mihalis Angelos*²² —

In contrast, full damages were awarded by the High Court to P in the *Amann case* even though there was some chance that D would have been entitled to cancel under the contract's cancellation clause. No discount in the damages was made because D could not prove that if it had not repudiated the contract, it would have terminated the contract under the cancellation clause. P's contractual rights continued and D's breach was compensated in full with damages.

— *The Commonwealth of Australia v Amann Aviation Pty Ltd*²³ —

¶6-330 Discharge by lapse of time. A contract may also be discharged (strictly speaking, made unenforceable) by the passage of time, in accordance with various statutory provisions covering the limitation of actions. The contract is not really discharged by the legislation, but is made unenforceable by it. Each State and Territory has a *Limitation Act*,²⁴ which provides that a right to sue must be enforced within a fixed period such as six years. The legislation does not give a right to sue in that period, but it makes clear that the right to sue cannot be exercised outside this limitation period. Where, for instance, a debt is at issue, the legislation does not say that the debt itself is extinguished; rather it says that the debt cannot be sued on outside the period. But if a security is being held for payment, for example, the security would be forfeited for non-performance. The reason for this rule is to prevent a person from facing liability for a perhaps indefinite period.

¶6-340 Discharge by operation of law. Certain rules of law may also have the effect of bringing about a discharge of a contract:

22. *Maredelanto Compania Naviera SA v Bergbau-Handel GmbH (The Mihalis Angelos)* [1971] 1 QB 164 at p 210.

23. (1991) 174 CLR 64; (1991) 66 ALJR 123; ¶6-455.

24. *Limitation of Actions Act 1958* (Vic); *Limitation Act 1969* (NSW); *Limitation*

of Actions Act 1974 (Qld); *Limitation of Actions Act 1936* (SA); *Limitation Act 1935* (WA); *Limitation Act 1974* (Tas); *Limitation Act 1985* (ACT); *Limitation Act 1981* (NT).

(1) *Merger.* Where the parties to a contract sign a deed dealing with the same subject matter as the contract, the contract is extinguished or swallowed up or merged into the subsequent deed. Action then lies on the deed only. The most practical example of merger is the effect of a court judgment, where a person's right of action under contract is merged in the judgment in the person's favour. Action is not taken to enforce the contract; rather it is taken to enforce the judgment.

(2) *Material alteration of written document.* A person altering a material part of a deed or a simple contract without the consent of the other party discharges the contract. But where there is a common contractual intention to which the contract might conform (such as an amount owing), a person may be taken to be authorised to fill in blanks to make the document agree with that common intention without discharging the contract.²⁵ Similarly, an immaterial alteration which does not alter the legal effect of the contract does not affect the enforceability of the contract.

(3) *Death.* Generally, the estate of a deceased person can sue and be sued in contract. Only a contract for personal service is discharged by death; in this case, the death of either party ends the contract.

(4) *Insolvency.* Some business advisers have been known to advise bankruptcy and a fresh start after discharge of bankruptcy, which can take place as little as six months after bankruptcy is declared (on application to the trustee) (§13-740). The basic effect of bankruptcy is to wipe the debtor's slate clean, and to pass all creditors' claims over to the trustee in bankruptcy, whose function it is to collect together the assets of the bankrupt estate and to distribute them as required by the *Bankruptcy Act 1966* (Cth). The winding up of a company may similarly result in a stay of proceedings against the company and the discharge of agreements entered by the company before its liquidation.

¶6-350 Discharge by frustration. Contract law recognises that if performance of a contract becomes impossible by a supervening event over which neither party has any control, and if there is no special provision in the contract to deal with this event, the contract is at an end and the parties discharged from further performance as regards further liability (ie liability not then actually accrued and enforceable), the loss lying where it falls.

Referred to as the doctrine of frustration, the currently accepted view states that frustration of contract can only arise if:²⁶

- (1) there is a significant or radical change to the nature of the contractual rights and obligations caused by the supervening event;
- (2) neither party to the contract has caused the supervening event;

25. *Walsh v Westpac Banking Corporation* (1991) 104 ACTR 30 (upholding co-director's implied authority to insert in blank space on form "\$120,000" as P's liability under guarantee for loan pre-signed by P).

26. *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675 at p 700; [1981] 1 All ER 161 at p 175.

- (3) there was no contemplation by the parties of the supervening event when they entered the contract (and there was therefore no provision in the contract to deal with it); and
- (4) in the new circumstances, it would be unjust to hold the parties to the literal sense of the contractual stipulations as originally agreed upon.

— *Case example* —

Radical change. P contracted with the railways authority to excavate tunnels and to do concrete work on the construction of the Eastern Suburbs Railway in Sydney in 1972. The work was to be completed in 130 weeks. Because the work included blasting and excavation which made a lot of noise and vibration, local residents were granted injunctions to restrain work between 10 pm and 6 am and, as a result, P could not complete the contract on time. P incurred additional costs and loss of profit as a result. Because the contract had been frustrated by the injunctions, the performance of the contract had become something radically different from that contracted for; P therefore succeeded in its claim for payment on a *quantum meruit* for the work done instead of payment under the original contract price.

Codelfa Construction Pty Ltd v
State Rail Authority of New South Wales²⁷ —

The rule of absolute contracts. Judges in the seventeenth century laid down the rule of absolute contracts, holding that where a person is bound by contract that person cannot escape contractual liability for damages by proving that extraneous circumstances rendered performance of the contract futile or impossible. Hence, in *Paradine v Jane*,²⁸ a lessee was sued for rent arrears. His defence was that the land in question had been occupied by the enemy and that as this was beyond his control, he could not be expected to pay rent from the profits because they did not exist. The defence failed on the basis that as he had covenanted to pay rent, he had to pay it — if he wanted an escape such as that put forward, such an escape should have appeared as a term of the lease. This rule was based upon the principle of freedom of contract. It relied upon the parties' right to protect themselves from unforeseen contingencies by an express provision in the contract. It is still good law today, but subsequent cases have considerably narrowed its scope by developing the doctrine of frustration.

Modification of the rule of absolute contracts. The harshness of the rule of absolute contracts was modified in *Taylor v Caldwell*,²⁹ a case which built on earlier exceptions and which provided the first attempt to state a general principle of frustration. In that case D had contracted to let P have the use of a music hall for four concerts. When the hall was destroyed by fire shortly before the commencement of the first concert, P sued for breach of contract under the rule of absolute contracts, alleging D's breach in not having the premises ready for use as contracted. It was held that because the music hall

27. (1982) 149 CLR 337; (1982) 56 ALJR 459.

28. (1647) Aleyn 26; 82 ER 897.

29. (1863) 3 B & S 826; 122 ER 309.

ceased to exist without fault of either party, both parties were excused from performance of their promises: "It was not this that I promised to do."³⁰

The doctrine of frustration now provides that subsequent impossibility may discharge a contract in the following situations:

(1) *Illegality*. If performance of the contract becomes illegal through a subsequent change in the law or the operation of the law, the contract is discharged by frustration. Hence the charterparty between A and B, whereby A was to load wheat in the Russian port of Odessa, was discharged by frustration after declaration of the Crimean War between, inter alia, Russia and England (1853-1856) because this would have involved A in trading with an enemy nation had A attempted to carry out the contract.³¹

(2) *Destruction of the subject matter of the contract*. A contract where the existence of a particular thing is essential is discharged by frustration if that thing ceases to exist, as in *Taylor v Caldwell* (above). In the case of a sale of goods, the Sale of Goods Acts provide that "[w]here there is an agreement to sell specific goods, and subsequently the goods, without any fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is thereby avoided."³²

(3) *Circumstances cease to exist*. Where the circumstances upon which the contract is based cease to exist, non-performance of the contract is mutually excused if those circumstances cease to exist without the fault of either party.

— *Case example* —

A crew member assigned half of his wages to his wife (P) under his two-year contract in 1914 with the shipowner (D). The ship was detained by the enemy during World War I and the crew member interned. The court held that because the contract was made on the assumption that the ship would be able to sail, P could not enforce the contract against D as the contract was discharged because the detention frustrated its performance.

— *Horlock v Beal*³³ —

(4) *Non-occurrence of event*. A contract is discharged by frustration if its performance depends upon the occurrence of an event and the event does not take place.

— *Case examples* —

Henry hired a flat from Krell in Pall Mall to watch the King's coronation procession. When the procession was cancelled, Henry declined to pay the balance of the rent. It was held that from the surrounding circumstances it

30. *Davis Contractors Ltd v Fareham Urban District Council* [1956] AC 696 at p 729.

31. *Espósito v Bowden* (1857) 7 E & B 763; 119 ER 1430 noted at ¶6-390.

32. *Goods Act 1958* (Vic) sec 12; *Sale of Goods Act 1923* (NSW) sec 12; *1896* (Qld)

sec 10; *1895* (SA) sec 7; *1895* (WA) sec 7; *1896* (Tas) sec 12; *Sale of Goods Act 1954* (ACT) sec 12; *Sale of Goods Act 1972* (NT) sec 12.

33. [1916] 1 AC 486.

could be inferred that both parties had agreed to the lease on the basis that the procession would be held along the published route. Although the terms of the agreement were general and unconditional, nevertheless Krell was not entitled to recover the balance of the rent fixed by the contract.

*Krell v Henry*³⁴

P (the lessee) also hired a room from D (a different lessor) to view that same coronation procession in 1902. As in *Krell v Henry*, P paid a deposit, and action was subsequently taken to enforce the contract. Holding that the obligation to pay the rent in full had arisen before the frustrating event, and that there was no rescission from the beginning, the court rejected P's claim for a refund of deposit, and upheld D's counter-claim for the balance unpaid.

*Chandler v Webster*³⁵

The lessee in *Chandler's case* was required to meet the expenses for the room in full, notwithstanding the cancellation of the procession, because under the contract his obligations for payment were to be finalised before the frustrating event. However, *Chandler v Webster* no longer represents the law, as it was overruled in the *Fibrosa case* in 1942:

— *Case example* —

P (a Polish firm) agreed to buy machinery from D (an English company) and paid a large deposit with its order. Germany's invasion of Poland and the outbreak of World War II in 1939 prevented delivery of the machinery to Poland. Action was commenced by P to recover the deposit after D's refusal to refund on the grounds that work on the machinery had already begun. In subsequent court proceedings, the trial judge, and the Court of Appeal, followed *Chandler v Webster*, holding that P could not recover its deposit. The House of Lords on appeal held in favour of P, not because the contract was void from the beginning, but in quasi-contract (¶6-510) on the basis that there had been a total failure of consideration.

*Fibrosa Spolka Akcyjna v Fairbairn
Lawson Combe Barbour Ltd*³⁶

(5) *Contract for personal services.* Provided the interruption is for a sufficient period to defeat the purpose of the contract, sickness, incapacity and death, and internment and military service, render performance of a contract for personal services impossible.

(6) *Government action.* Action or inaction by government may frustrate a contract by rendering it something entirely different from that originally entered (such as in *Leahy's case*, ¶5-070). Examples include failure to issue a licence or permit, industrial unrest, requisition of labour or materials in time of war, and international events (such as declaration of war,³⁷ and closure of transport lanes, etc).

34. [1903] 2 KB 740; [1900-03] All ER Rep 20.

35. [1904] 1 KB 493.

36. [1943] AC 32; [1942] 2 All ER 122.

37. *Finlvet AG v Vinava Shipping Co Ltd (The Chrysalis)* [1983] 1 WLR 1469; [1983] 2 All ER 658 (*Iraq v Iran*); Kahn, AN, *Frustration of contract by war* (1984) 128 Sol Jo 196.

Example

The Gulf war. Iraq's invasion of Kuwait in August 1990 led to immediate United Nations resolutions prohibiting trade with Iraq or Kuwait. Military intervention by many countries including Australia in January 1991 also made trade a practical impossibility. Existing contracts (such as those for import, export, construction and employment) would have been impossible to perform in Iraq or Kuwait due to frustration. However, precontractual requirements and subcontracts, such as supply of goods to an Australian port ready for loading, would stand unless contractual terms included provision for such eventuality.³⁸

Consequences at common law of frustration of contract

- Where an amount has been paid for performance under a contract, but there has been no performance at the time of frustration, the party paying is entitled to reimbursement under the principle of unjust enrichment (§16-510), since consideration for the payment has failed.
- Similarly, where under a contract an amount is due which remains unpaid at the time of frustration, and if there has been a total failure of consideration for that payment, this failure is a defence to a demand for payment.
- Although the contract is discharged from the moment the frustrating event occurs, the contract remains valid and binding until this time; contractual rights accrued before frustration remain legally enforceable.
- There is no legal right to reimbursement where there has been only a partial failure of consideration, or for costs incurred before frustration.
- In the case of claims for non-monetary recovery, restitution runs into the obstacle of the common law doctrine of entire contracts and may prove to be impossible.³⁹

§16-370 Statutory reform of the doctrine of frustration.

Because of the shortcomings of the operation of the doctrine of frustration at common law, several jurisdictions have attempted to reform this law by legislation which alters the legal consequences of frustration.

(1) *Victoria* (based on the UK legislation⁴⁰). The *Frustrated Contracts Act 1959* (Vic) deals with the consequences of frustration in sec 3(1):

"... where a contract becomes impossible of performance or is otherwise frustrated ... and the parties thereto are for that reason discharged from the further performance of the contract ..."

38. eg Ludlow, M, *Iraq invasion of Kuwait: effect on contracts of UK firms and companies* (1990) 18 International Business Lawyer 496.

affirmed on other grounds [1983] 2 AC 352.

39. *BP Exploration Co (Libya) Ltd v Hunt* (No 2) [1979] 1 WLR 783 at p 798;

40. *Law Reform (Frustrated Contracts) Act 1943* (UK).

The Act gives unfettered discretion to the court to achieve a just solution by providing in sec 3(2):

“All sums paid or payable to any party in pursuance of the contract before the time of discharge shall, in the case of sums so paid, be recoverable and in the case of sums so payable cease to be so payable:

Provided that, if the party to whom the sums were so paid or payable incurred expenses before the time of discharge in or for the purpose of the performance of the contract, the court may, if it considers it just to do so having regard to all the circumstances of the case, allow him to retain or (as the case may be) recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.”

In short, sec 3(2) provides that if money is paid or payable before discharge, then the party can recover the money paid, and need not pay the rest. Moreover, if a party to whom sums are paid has incurred expenses, the court may in its discretion allow it to retain the whole payment of such sums. Or if a party to whom sums are payable has incurred expenses, the court may in its discretion allow it to recover the whole or any part of such sums. In relation to this, note that:

- (a) before expenses can be recovered, money must have been paid or payable before discharge;
- (b) no more than the amount paid or payable can be collected — the total amount of expenses cannot be recovered;
- (c) the court has discretion to decide how much is allowed.

Section 3(3) states that the court in exercising its discretion in making orders must have regard to all circumstances, in particular the amount of expenses incurred by the benefited party and the effect in relation to the said benefit of the circumstances which gave rise to the frustration.

In the situation where the plaintiff sues for work such as labour and materials but does not recover because payment is still due at the end of the contract, consideration cannot be apportioned; it is therefore doubtful whether the Victorian Act would improve the situation, because expenses cannot be recovered if no sum is payable or paid for discharge, and furthermore a benefit would have to have been conferred on the plaintiff.

— Case example —

The plaintiff plumbing and heating contractors had agreed orally to install heating and air conditioning for a hotel renovation. The building was destroyed by fire before the contract was complete. The plaintiff sued for the contract price or alternatively the value of the work done to date. It was held by the court that both claims failed. On the facts the contract called for completion before payment, so the contract price had not yet become due.

- At common law a party which fails to complete its contract cannot recover even if the failure to complete is beyond its power.
- The *Frustrated Contracts Act 1956* (Newfoundland) gave no relief as it only allowed recovery for whole or part of a benefit conferred on the

defendant and, as there was no evidence of benefit conferred on the defendant, the plaintiff failed.

*Parsons Bros Ltd v Shea*⁴¹ —

(2) *New South Wales*.⁴² The *Frustrated Contracts Act 1978* (NSW) departs from the UK model by providing a complicated scheme of adjustment to ensure that any loss arising by frustration is shared equally between the parties, and it provides in Part III a detailed code for adjustment on frustration rather than leaving this to the discretion of the courts. Money paid before frustration is to be repaid (sec 12), and promises due but not performed due to the frustration are discharged except to the extent necessary to support a claim for damages (sec 7).

(3) *South Australia*. The *Frustrated Contracts Act 1988* (SA), attempting to overcome the arguable failure of the legislation of the other States to provide a comprehensive scheme of adjustment, sought a fresh approach to frustration by invoking the principle of distributive justice.⁴³ All parties' costs and benefits arising before the frustration are aggregated, and the amount is divided among the parties. The Act ensures that "no party is unfairly advantaged or disadvantaged" (sec 7(1)) in achieving a single, simple adjustment of the losses on frustration, and for the purposes of this adjustment sec 7(2) provides that:

- "(a) the value of contractual benefits received up to the date of frustration by each party to the contract will be assessed as at the date of frustration and those values aggregated;
- (b) the value of the contractual performance, up to the date of frustration, of each party to the contract will be calculated and those values aggregated;
- (c) the aggregate amount arrived at under paragraph (b) will be subtracted from the aggregate amount arrived at under paragraph (a), and the remainder notionally divided between the parties in equal shares;
- (d) an adjustment will be made between the parties so that there is an equalization of the contractual return of each at the figure attributed under paragraph (c)."

REMEDIES

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41. 53 DLR 2d 86 (1966).

42. Based on *Report of the Law Reform Commission on Frustrated Contracts*, LRC 25, Government Printer, NSW, 1976. The legislation is similar to that enacted in British Columbia in 1974.

43. Based on Law Reform Committee of South Australia, *Thirty-seventh report*

relating to the doctrines of frustration and illegality in the law of contract, Adelaide, 1977, and *Seventy-first report relating to the doctrine of frustration in the law of contract*, Adelaide, 1983. See, eg, Stewart, A, *The South Australian Frustrated Contracts Act* (1992) 5 JCL 220.

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¶6-380 Remedies available. The methods which are given by the law to an injured party to enforce a right or to redress an injury are known as "remedies":

- In a general sense "remedy" refers to an action at law (whether under contract, tort or other law such as the *Trade Practices Act 1974* (Cth)) for damages, rescission (¶5-700; ¶6-280), or an action in equity for specific performance (¶6-400), injunction (¶6-410), account of profits or restitution (¶6-510). Damages can also be awarded in addition to or instead of these two equitable remedies.⁴⁴ Where one of the parties to a contract unjustifiably fails or refuses to perform, the other party has a right of action against that person.
- In a particular or narrow sense, "remedy" is the form of action which may be used to recover damages for breach of contract. It includes rights under the *Trade Practices Act* sec 87, which confers on the courts wide powers to "rewrite" contracts where a breach of the Act is proved (¶7-850; ¶8-860).

In response to the breach or the anticipated breach (ie anticipatory breach: ¶6-320), the innocent party has a choice (election) between affirming the contract (confirming that the contract continues, subject to the later right to sue) or terminating the contract.

Once the innocent party has decided to treat the contract as terminated, it has a further choice. It is, of course, relieved from the duty of further

44. Damages and an account of profits are alternative, not cumulative, remedies: *Tang Man Sit v Capacious Investments*

Ltd [1996] 2 WLR 192, noted (1996) 70 ALJ 540.

performance of its contractual obligations. Additionally the innocent party may sue for damages, if it has sustained any; or it may wait, and if sued by the other party, set up as a defence that other party's breach.

When the innocent party elects to bring an action, again a number of possibilities open up, depending on the circumstances of the case. The innocent party may bring an action for money damages. This might, in the appropriate circumstances, take the form of an action for *quantum meruit* or restitution, ie an action for the reasonable value of the goods supplied or the work performed under the contract (see ¶6-290; ¶6-510).

In certain situations the injured party may, instead of bringing an action for money damages, bring an action in equity for specific performance. In other cases, the injured party may bring an action for the rescission (or cancellation) of the contract (¶6-280). A contract which has been rescinded is considered to be void *ab initio*. However, should the innocent party bring an action for rescission it is necessary that full restitution be possible, ie that both parties be restored to their respective original positions. This means that the innocent party must, generally, return any money or property acquired under the contract (¶5-700).

In most cases, the only relief which will be available to the innocent party in case of a breach will be an action for money damages. The task facing the court in such a case is to find that sum of money which will, when awarded to the innocent party, put it in as good a position as it would have been in had the contract been performed.

If supported by the facts, a plaintiff may sue in both contract and tort, bearing in mind the difference in assessment of damages (¶4-180). The existence of an express term in a contract does not prevent a person from electing to sue in tort instead of relying on the breach of contract.⁴⁵

¶6-390 Keeping the contract open: election not to discharge. The innocent party may, as indicated in ¶6-380, choose not to treat the contract as terminated (discharged) in which case it continues for the benefit of the parties, subject to any claim for damages. The contract thus remains "open", which means that the innocent party could later be made to perform, even though at that later date that party may wish to avoid the whole contract. The decision by the innocent party to keep the contract "open", ie not to treat the other party's breach as a discharge of the contract, can lead to unexpected consequences.

— *Case example* —

D agreed to charter P's ship and to load it with a cargo at Odessa in Russia within 45 days. Some time before this period had expired, D advised P that as it would be impossible for him to obtain the cargo in question P should leave port. P refused to leave and stayed on at Odessa hoping that D would

45. *British Columbia Hydro and Power Authority v BG Checo International Ltd*

99 DLR (4th) 577 (1993), noted (1994)
68 ALJ 224.

be able to obtain the cargo and load the ship. Before the end of this 45-day period, the Crimean War between Russia and England broke out and because of this it would have been illegal — trading with the enemy is illegal (§5-830) — for D to load the ship. Whereas the plaintiff could have had a good action for breach if he had sued immediately on the defendant's refusal to load, he lost that right of action when the war broke out. By refusing to treat the contract as discharged on the defendant's breach, the plaintiff had kept the contract "open" or subsisting and thus the defendant was provided with a good defence to the plaintiff's suit.

Avery v Bowden¹

In contrast, the English courts have upheld the right of the "innocent" party P (an advertising agency) to proceed with the contract (a three-year advertising contract) even after notice of cancellation (defined as repudiation) by "defaulting" party client D, thereby either allowing P to force D to contract, or in effect allowing P to obtain a decree of specific performance (§6-400) in circumstances which would not otherwise warrant such an order.² P was held entitled to the whole of the contract price.

However, the commencement of legal proceedings in relation to a contract does not necessarily indicate repudiation of the contract, and, for example, a purchaser claiming the right to terminate a contract of sale does not thereby repudiate (giving the other party a right to rescission and damages), according to the following principles:³

- (1) *the Spettabile principle*: the fact that a party issues a writ seeking a court determination as to whether it is bound to perform a contract does not of itself evidence a repudiation of the contract, since if the party loses, it is assumed that it will perform the contract.⁴
- (2) *the DTR Nominees principle*: a court will not readily infer from a party's genuine insistence on a wrong construction of a contract that it is unwilling to perform the contract according to its true construction, unless persisted with "willy nilly in the face of a clear interpretation of the true agreement".⁵

To be entitled to terminate for breach of condition (§6-050) giving rise to anticipatory breach (§6-320), a person must at the time of the termination be innocent and be willing to perform the contract on its proper interpretation, otherwise that person could profit from misinterpretation of the contract.

1. (1855) 5 E & B 714; 119 ER 647. See also *Espósito v Bowden* (1857) 7 E & B 763; 119 ER 1430; on illegality as giving rise to frustration of contract, see §6-350.

2. *White & Carter (Councils) Ltd v McGregor* [1962] AC 413; [1961] 3 All ER 1178; criticised by Young, PW, *Repudiation* (1985) 1 Aust Bar Rev 21.

3. As in *Lombok Pty Ltd v Supetina Pty Ltd* (1987) 14 FCR 226; (1987) ATPR

§40-767, noted at (1987) 61 ALJ 301; discussed in Brabazon, CJL and Martin, GC, *Beware the contingent rescinder* (1987) 17 QLSJ 259.

4. *Spettabile Consorzio Veneziano di Armamento e Navigazione v Northumberland Shipbuilding Co Ltd* (1919) 121 LT 628.

5. *DTR Nominees Pty Ltd v Mona Homes Pty Ltd* (1978) 138 CLR 423.

¶6-400 Equitable remedies: specific performance. The remedy of specific performance is a court order to force the performance of an obligation, for example in circumstances where a damages award of money would not be good enough (especially in the circumstances where the subject matter of the contract is unique and cannot be obtained elsewhere). Examples of the award of specific performance include:

- contracts for sale or purchase of land and buildings, and
- contracts for sale or purchase of personal property,⁶ especially if a damages award at common law would be different from the amount promised by the person in breach (for example, a speculative promise).

— *Case example* —

D was the lessee of a supermarket which was the largest shop in a shopping centre. One of the covenants in the lease required D to remain open for retail trade during usual business hours. When D closed the business after incurring trading losses, P (the lessor) applied for specific performance of the covenant to “keep open”. The court did not grant specific performance, on the basis that it would give P more than P had bargained for — P was free to sue for damages for the breach of covenant. Ensuring compliance with an order of specific performance would drain the resources of the court, and would bind the parties together in a continuing and possibly hostile relationship. It was the settled practice of the court not to make an order requiring a person to carry on a business, although in exceptional circumstances such as a personal breach of faith it may grant specific performance.

— *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd*⁷ —

Specific performance will not be awarded if it involves injustice to the defendant, such as delay by the plaintiff (“laches”: ¶6-500), unfairness or unconscionability. Making an order may be pointless, and because “equity does nothing in vain” (¶1-010), the courts are reluctant to make an order over contracts involving continued supervision or contracts of personal service, for example a contract for a footballer to play or for a performer to sing. However, the same result may be achieved by the court’s preventing the breach of such a contract by an injunction. The injunction would be phrased in such terms as to prevent the footballer from playing for any other football club, or the singer from performing in other theatres during the period of the contract (¶6-410).

¶6-410 Equitable remedies: injunction. An injunction is a court order to restrain the doing of some act or to require a person to do some act. In respect of contracts, the injunction might be used to prevent a party

6. As confirmed in Sale of Goods legislation under the marginal heading “Specific performance” or “Selling of proceedings in equity” (see ¶7-015): sec 58 (Vic);

sec 56 (NSW); sec 53 (Qld); sec 51 (SA); sec 51 (WA); sec 56 (Tas); sec 55 (ACT); sec 56 (NT).

7. [1997] 3 All ER 297 (HL).

from committing a breach, as by requiring that party to refrain from selling to anyone else the land contracted to be sold to you.

An injunction may be granted to restrain breach of fiduciary duty (¶9-770), or breach of a negative covenant or negative stipulation in a contract even though this may amount to ordering specific performance of a contract. A contract for personal service is not normally subject to specific performance (¶6-400) but may be enforced by injunction:

— *Case examples* —

Johanna Wagner (D) was an opera singer who had contracted with P to sing at Her Majesty's Theatre exclusively for three months. The contract contained a term that she would not sing elsewhere during that time without the written consent of P. When she entered a contract with Frederick Gye to sing at Covent Garden Theatre, P applied for and was awarded an injunction to restrain D from singing anywhere else during a period of time specified in the contract. The Lord Chancellor said:

"It is true that I have not the means of compelling her to sing, but she has not cause of complaint if I compel her to abstain from the commission of an act which she has bound herself not to do, and thus possibly cause her to fulfil her engagement. The jurisdiction which I now exercise is wholly within the power of the court ..."

— *Lumley v Wagner*⁸ —

Similarly, an injunction was granted to Channel 7's TV program "Beyond 2000" to prevent its presenter Tracy Curro from breaching her service contract by switching to Channel 9's "60 Minutes": "Enforcing the negative covenants [not to act as a presenter for anyone else] will merely prevent her from acting as a presenter on the 60 Minutes program ... If she suffers from lack of exposure, that comes about by her determination not to honour the agreement she made to act as presenter for Beyond for the period of her contract."

— *Beyond Productions Pty Ltd v Curro*⁹ —

Injunctions under the *Trade Practices Act 1974* (Cth) are noted at ¶8-810—¶8-820.

¶6-415 Equitable remedies: the Mareva order. Especially worrying in these days of international financial markets and instant communication is the possibility that a defendant may move assets from the jurisdiction of the court to make any court judgment ineffective. Where there is a real risk that assets may be moved, a court may issue a Mareva order to

8. (1852) 1 De GM & G 604; (1852) 42 ER 687; [1843-60] All ER Rep 368. See also *Warner Bros Pictures Inc v Nelson* [1936] 3 All ER 160 (similar injunction issued against actor Bette Davis).

9. (1993) 30 NSWLR 337.

preserve assets to prevent their being moved from the jurisdiction or otherwise disposed of.¹⁰ A Mareva order can be made against a third party.¹¹

Because Mareva orders have the potential seriously to interfere with the legal rights of the defendant, a plaintiff must establish in seeking a Mareva order:

- (1) the existence of a claim with a substantive cause of action such as a claim for damages, and the likelihood of success. The plaintiff must prove a strong *prima facie* case, as the Mareva order is a limited exception to the general rule that a plaintiff must obtain judgment before enforcing it. The plaintiff may be required to lodge a security and/or to compensate the defendant if the claim is later proved unjustified;
- (2) the reasons for believing that the defendant has assets in the jurisdiction; and
- (3) the existence of a real risk that the assets will be removed or disposed of before judgment.

However, the jurisdiction to grant a Mareva order is not to be exercised to prevent a defendant from dealing with assets in the ordinary course of business.

Case law has confirmed the power of the Federal Court to grant a Mareva order or a Mareva-type order as a form of pre-trial attachment for breaches of, for example, sec 52 of the *Trade Practices Act 1974* (Cth) (§8-810).

¶6-416 Equitable remedies: the Anton Piller order. During or even before legal proceedings, vital evidence can go missing. In the interests of justice, the court in exercising a court of equity's inherent powers can make an order *ex parte* (after hearing the applicant only) to obtain evidence necessary to the applicant's case which may not be in existence for a later court order for discovery. Three pre-conditions were laid down in the foundation *Anton Piller case*.¹²

"First, there must be an extremely strong *prima facie* case. Secondly, the damage, potential or actual, must be very serious to the applicant. Thirdly, there must be clear evidence that the defendants have in their possession incriminating documents or things, and that there is a real possibility that they may destroy such material before an application *inter partes* can be made."

10. *Mareva Compania Naviera SA v International Bulkcarriers SA, The Mareva* [1980] 1 All ER 213; [1975] 2 Lloyd's Rep 509.

11. *Cardile v LED Builders Pty Ltd* (1999) 73 ALJR 657. In this case the High Court stated *obiter* that Mareva injunctions

should henceforth be known as Mareva orders in Australia because the order does not have all the features of an injunction: ¶6-410. Kirby J preferred the term "asset preservation order".

12. *Anton Piller KG v Manufacturing Processes Ltd* [1976] Ch 55 at p 62.

An Anton Piller order authorises the entering of premises of a prospective defendant to inspect documents and records, removing those relevant to forthcoming proceedings and seizing offending items (especially in copyright infringement cases: ¶3-540). The order can be issued independently of other court-ordered powers of inspection under various Rules of Court. As with Mareva orders (¶6-415), Anton Piller orders also raise civil liberties and right to privacy issues, and in particular:

- (1) the order will only be made in exceptional cases and should not be used as a substitute for normal injunctive relief;
- (2) the order does not authorise a general search for offending material, and will be limited to specified material; and
- (3) the defendant's rights are to be respected, such as the right to obtain legal advice. The applicant cannot force entry and may be required to compensate for damage.

¶6-417 Damages in equity. Damages may be awarded by a court of equity in addition to the equitable remedies discussed above (¶6-400—¶6-416). The traditional view is that exemplary damages are not awarded in equity because an equity court is not a court of penal jurisdiction, but there is clear authority that equity can award exemplary damages where there is fraud.¹³

¶6-420 Damages recoverable: the principle of remoteness. Suppose that the injured party has elected to sue for money damages. After the court has decided to award a plaintiff damages it must then decide how much and for what; ie it must determine how far it is willing to go in holding the defendant liable for the consequences of the breach. This problem faced by the court is similar to the problem of "proximate cause" in tort and it obviously involves consideration by the court of many matters (see ¶4-130).

There may be many sorts of losses flowing from any given breach of a contract. Some of these will seem obvious, and some will require imagination and perhaps some straining of logic. The courts' job is to draw the line.

Suppose that you are five minutes late getting home one night from the office because your garage mechanic failed to have your car ready for you at exactly 5.00 pm as promised (breach of contract). When you get home you find that a fire has destroyed your garage, where you were storing some valuable paintings which you had contracted to sell to the local art gallery at a very high price; that your prize Dalmatian, locked in the backyard, has jumped the fence to avoid the fire and has injured your next-door neighbour, and that your neighbour on the other side has had to be taken to hospital to be treated for smoke inhalation. Had your mechanic not held you up you

13. eg *Exemplary damages in equity* (1995) 69 ALJ 773; for such damages at common law, compare ¶6-460.

would have been home five minutes earlier and you would have been able to prevent all this from happening.

It would be possible, presumably, to say that all these harms were caused by the failure of the mechanic to have your car ready — the mechanic's breach of the contract with you. However, fortunately, the courts have taken a more conservative view and would deem it most unfair to hold the mechanic liable for all those losses. The court must draw the line somewhere; it must determine for which of the consequences that follow a breach the defendant will be held liable. The answer is in each case a question of fact.

¶6-430 The rule in *Hadley v Baxendale*. The courts have guidelines to follow in determining for which losses the defendant should be liable as a result of his breach. The main guidelines to help a court draw that line were laid down in a famous case, and have become known as “the rule in *Hadley v Baxendale*”:

— *Case example* —

P was a miller at Gloucester. When the driving shaft of the mill was broken, P instructed D, a carrier, to take it to the manufacturers at Greenwich so that they could make a new one using the old one as a pattern. D promised to deliver the broken crankshaft the next day, but it was not delivered for several days. D's only information and knowledge about the crankshaft was that “the article to be carried was the broken shaft of a mill and that the plaintiffs were the millers of that mill”. Because of D's delay — caused by his own negligence — the mill was idle for a longer period of time than it would have been had he not breached his contract of carriage.

— *Hadley v Baxendale*¹⁴ —

The plaintiff sued for the loss of profits caused by the defendant's delay. But the court found in favour of the defendant, holding that the defendant could not, on his instructions, reasonably have foreseen that his delay in making delivery of the shaft would result in a prolonged shutdown of the mill. The court held that the loss of profits was not a usual or normal type of damage, for it could reasonably be expected in such circumstances that a miller would have a spare crankshaft ready for emergencies. Since the plaintiff had not made known to the defendant any extraordinary circumstances, it was not proper to consider such loss of profits when assessing damages. The court stated:

“Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie according to the usual course of things from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the

14. (1854) 9 Exch 341; 156 ER 145.

probable result of the breach of it. If special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract which they would reasonably contemplate would be the amount of injury which would ordinarily follow from a breach of contract under the special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them.”

The “rule in *Hadley v Baxendale*” has two limbs:

- (1) **First limb** — where the damage flows from a breach arising “naturally” or in the “usual course of things”, ie the damages are or should have been obvious or expected in the normal course of events, and includes compound interest for loss of the use of money.
- (2) **Second limb** — such damages “as may reasonably be supposed to have been in the contemplation of both parties, at the time when they made the contract”, and this causes most of the litigation. For this category contemplates the case where a plaintiff suffers loss in excess of those losses which would normally be expected to follow in the usual course of things. Such losses are often referred to as “extraordinary damages”. The courts will not allow recovery of these unless, as the court in *Hadley* stated, they were “in the contemplation of both parties”, ie unless the plaintiff has brought any such special circumstances to the attention of the defendant at the time of making the contract. If the plaintiff has done this, then the defendant will be deemed to have accepted the risk of any extraordinary damages should they arise by virtue of the defendant’s default.

¶6-440 Assessment of damages: criterion of probability.

The rule in *Hadley v Baxendale* was refined further in the *Victoria Laundry case*, the second classic case on the assessment of damages, some 95 years later:

— Case example —

P, who ran a laundry and dry cleaning company, agreed to buy a boiler from D in order to expand the business generally and to procure certain “highly profitable” dry cleaning contracts. To this end they contracted with the defendants, an engineering firm, who promised to sell and deliver the required boiler in June. The defendants, who were aware of the nature of the plaintiffs’ business, knew that the plaintiffs were “most anxious” to have the new boiler installed and in use “in the shortest possible space of time” but were unable to deliver the boiler until the following November. The

defendants did not know of the “highly profitable” dry cleaning contracts that the plaintiffs were negotiating for. Thus when the plaintiffs sued the defendants for loss of profits, the court limited the damages to the loss of profits “normally” or “usually” occurring; that is, the plaintiffs were allowed to recover for the loss of normal or usual profits that could reasonably be expected to have been earned in its normal business. However, the court would not allow the plaintiffs any damages for the loss of profits in relation to the “highly profitable” contracts it might have obtained, as these were not “in the contemplation of both parties” — the defendants had no notice of any such special circumstances.

*Victoria Laundry (Windsor) Ltd v
Newman Industries Ltd*¹⁵ —

Asquith LJ stated:¹⁶

“What propositions applicable to the present case emerge from the authorities as a whole ...? We think they include the following:

(1) It is well settled that the governing purpose of damages is to put the party whose rights have been violated in the same position, so far as money can do so, as if his rights had been observed ... This purpose, if relentlessly pursued, would provide him with a complete indemnity for all loss *de facto* resulting from a particular breach, however improbable, however unpredictable. This, in contract at least, is recognised as too harsh a rule. Hence,

(2) In cases of breach of contract the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach.

(3) What was at that time reasonably foreseeable depends on the knowledge then possessed by the parties, or, at all events, by the party who later commits the breach.

(4) For this purpose, knowledge ‘possessed’ is of two kinds — one imputed, the other actual. Everyone, as a reasonable person, is taken to know the ‘ordinary course of things’ and consequently what loss is liable to result from a breach of that ordinary course. This is the subject matter of the ‘first rule’ in *Hadley v Baxendale* [(1854) 9 Exch 341] but to this knowledge, which a contract-breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case knowledge which he actually possesses of special circumstances outside the ‘ordinary course of things’, of such a kind that a breach in those special circumstances would be liable to cause more loss. Such a case attracts the operation of the ‘second rule’ so as to make additional loss also recoverable.

15. [1949] 2 KB 528; [1949] 1 All ER 997. In the words of *Ryan J*, “a loss is recoverable if its occurrence was a serious possibility or a real danger; it is not necessary to establish that the loss was a

near certainty or an odds on probability”: *Smith v Ryngiel* [1988] 1 Qd R 179 at p 189.

16. [1949] 2 KB 528 at pp 539-540; [1949] 1 All ER 997 at pp 1002-1003.

(5) In order to make the contract-breaker liable under either rule it is not necessary that he should actually have asked himself what loss is liable to result from a breach. As has often been pointed out, parties at the time of contracting contemplate not the breach of the contract, but its performance. It suffices that, if he had considered the question, he would as a reasonable man have concluded that the loss in question was liable to result. ...

(6) Nor, finally, to make a particular loss recoverable, need it be proved that on a given state of knowledge the defendant could, as a reasonable man, foresee that a breach must necessarily result in that loss. It is enough if he could foresee it was likely so to result. It is enough ... if the loss (or some factor without which it would not have occurred) is a 'serious possibility' or a 'real danger'. For short, we have used the word 'liable' to result. Possibly the colloquialism 'on the cards' indicates the shade of meaning with some approach to accuracy."

The propositions developed by *Asquith* LJ are considered by some to be too wide, and to approach closely the criteria for determining liability which are used in tort. Critics of the propositions of *Asquith* LJ have included Lord *Reid* in *Koufos v C Czarnikow Ltd*.¹⁷ He objected to the test of "reasonable foreseeability" (proposition (2)), disagreed with the "liable to result" criterion of proposition (5), and went on to say, in criticism of proposition (6):

"It has never been held to be sufficient in contract that the loss was foreseeable as 'a serious possibility' or a 'real danger' or as being 'on the cards'. It is on the cards that one can win £100,000 or more for the stake of a few pence — several people have done that. And anyone who backs a hundred to one chance regards a win as a serious possibility ... Suppose one takes a well-shuffled pack of cards, it is quite likely or not unlikely that the top card will prove to be a diamond: the odds are only 3 to 1 against. But most people would not say that it is quite likely to be the nine of diamonds for the odds are then 51 to 1 against. On the other hand I think that most people would say that there is a serious possibility or a real danger of its being turned up first and of course it is on the cards."

The suggestion is sometimes put forward that the test of remoteness of damage is, or should be, the same in breach of contract cases as it is in tort cases. But Lord *Reid* attacked this suggestion, saying:

"The modern rule of tort is quite different and it imposes a much wider liability. The defendant will be liable for any type of damage which is reasonably foreseeable as liable to happen even in the most unusual case, unless the risk is so small that a reasonable man would in the whole circumstances feel justified in neglecting it. And there is good reason for the difference. In contract, if one party wishes to protect himself against a risk which to the other party would appear unusual, he can direct the other

17. [1969] 1 AC 350 at p 390, 385; [1967] 3 WLR 1491 at pp 1506, 1502.

party's attention to it before the contract is made ... But in tort there is no opportunity for the injured party to protect himself in that way, and the tortfeasor cannot reasonably complain if he has to pay for some very unusual but nevertheless foreseeable damage which results from his wrongdoing. I have no doubt that today a tortfeasor would be liable for a type of damage as unlikely as was the stoppage of Hadley's Mill for lack of a crankshaft: to anyone with the knowledge the carrier had that may have seemed unlikely but the chance of it happening would have been seen to be far from negligible. But it does not at all follow that *Hadley v Baxendale* would today be differently decided."

Hence the rule in *Hadley v Baxendale* — that consequential damages will not be awarded unless the defendant was put on notice of the special circumstances giving rise to them — is widely accepted as one of the pillars of the law of contract:

- A client of the defendant accountants overpaid tax for several years due to an error by the accountants in under-calculation of the amount of depreciation allowed as a tax deduction. The client was awarded damages for breach of contract and negligence, and damages by way of interest for the loss of the use of the money:

"... in claims for damages for loss of the use of money, a plaintiff who actually incurs the expense of interest on borrowed money to replace money paid away or withheld from him will be entitled to recover that cost, so long as the defendant was aware of the special circumstances, but not otherwise. The expense must fall within the second limb of *Hadley v Baxendale* in order to be compensable. It cannot fall within the first limb because the defendant cannot be fixed with imputed knowledge of the plaintiff's financial situation and of his need to incur expense by borrowing money. Furthermore, a plaintiff who is not compelled to borrow money by way of replacement of money paid away or withheld will not be entitled to recover for the opportunity lost to him, ie, lost opportunity to invest or to maintain an investment ...

The requirement of foreseeability is no obstacle to the award of damages, calculated by reference to the appropriate interest rates, for loss of the use of money. Opportunity cost, more so than incurred expense, is a plainly foreseeable loss because, according to common understanding, it represents the market price of obtaining money."¹⁸

- When D failed to make payments to P (a company) under their contract, P went into voluntary administration. P was successful in claiming its legal and accounting costs under the second limb in *Hadley v Baxendale*

18. *Hungerfords v Walker* (1989) 171 CLR 125 at pp 142-143, noted eg (1990) 64 ALJ 364; ¶4-260.

as D was on notice that P depended on the cashflow from the contract to stay in business.¹⁹

¶6-450 Damages recoverable: “general” and “nominal”.

Once the problem of remoteness has been solved, ie once the court has determined for what damages the defendant should be liable, the next problem is to determine the quantum — how much the defendant should be made to pay. The basic aim of the court is to put the plaintiff in as good a position financially as the plaintiff would have been in had the defendant not breached the contract. Thus the question is, how much money will make the injured party whole; how much money will rectify the wrong suffered (compare the position in tort at ¶4-180ff).

Compensation to the plaintiff for loss is the purpose of an award of damages. Although P should not be actually enriched as a result, “new” for “old” without allowance may achieve enrichment in the situation where there is no alternative, such as damages to rebuild a factory,²⁰ or damages to replace a component part (with a remaining life expectancy of 3¼ years) with a new part (with a 7-year life expectancy).²¹

It must be kept in mind that for a plaintiff (injured party) to recover a sum of money as damages for harm suffered as a result of the defendant’s breach of contract, the plaintiff must be able to prove loss. A plaintiff who cannot prove loss cannot recover damages.

— Case example —

D contracted to buy a second-hand BMW 2002 motor car from P, a car dealer. When D refused to accept it, he was sued by P for “loss of profit”, namely the difference between the £1,325 P had paid and the £1,670 agreed with D. The court, in denying P’s claim, stated that when the subject matter of a repudiated sale was a unique item such as a second-hand car, as in this case, “for which there was no available market ... the sellers could recover as damages only the particular loss sustained on the transaction and nothing more”. In this case, since P had in fact sold the car two months later to another person for a price higher than the price agreed to with D (£1,770), P had “suffered no loss and could not recover any damages”.

— *Lazenby Garages Ltd v Wright*²² —

Nominal damages. Because there has been a breach of contract, the plaintiff may be able to recover what is known as “nominal” damages (noted also at ¶4-200). In effect, “nominal” damages are what the courts allow a plaintiff for proving the point: the plaintiff has been able to show that the defendant

19. *Landoro (Qld) Pty Ltd (Administrator Appointed) v Jensen International Pty Ltd* [1999] QCA 318. The costs were those of administering a deed of company arrangement under the Corporations Law Pt 5.3A: ¶9-620.

20. eg *Harbutt’s Plasticine Ltd v Wayne Tank & Pump Co Ltd* [1970] 1 QB 447.

21. *Bacon v Cooper (Metals) Ltd* [1982] 1 All ER 397.

22. [1976] 1 WLR 459; [1976] 2 All ER 770.

did breach the contract even though the plaintiff cannot show the loss of anything by that breach.

— *Case example* —

P, a motor car dealer, agreed to sell a new Hillman Minx car to D for £773.17s, the retail price fixed by the manufacturers. (NB: in Australia resale price maintenance is illegal: ¶8-440ff.) When D refused to complete the contract within 10 days, P sold the car to a third party at the same price, and sued D for breach of contract. P claimed as damages £97.15s which he estimated was the loss of profit he would have made on the sale to D had it gone through. At the trial it was shown that P had sold that particular car to another buyer for a price that gave P the same profit as he would have made from D, and also that P was able to sell all the cars he could get of the same type. The court held that since P could obviously not prove any loss he was not entitled to any “general” damages; but since P was able to prove a breach of contract by D, P was entitled to “nominal” damages and thus the court awarded P nominal damages of 40 shillings.

— *Charter v Sullivan*²³ —

Exemplary damages for breach of contract. Exemplary or punitive damages designed to achieve retribution may be awarded in tort (¶4-200) but not for breach of contract although “it can be argued that, strictly speaking, the matter remains open.”²⁴

¶6-455 Damages recoverable: “expectation loss” and “reliance loss”. The rule in *Hadley v Baxendale* (¶6-430) sets out the damages which can be awarded for loss for breach of contract and the limitations to be applied to damages in the case of remoteness. Where there has been a breach of contract, the party sustaining loss is entitled to be placed in the position it would have been in had the contract been performed.²⁵ The expressions “expectation damages”, “damages for loss of profits”, “reliance damages” and “damages for wasted expenditure” are indications of this central principle. They are not alternatives and the plaintiff does not have to elect one or the other.

Expectation damages. An award of damages in contract is to protect the plaintiff’s expectation of receiving the defendant’s performance. The expectation of prospective benefit arises out of or is created by the contract.²⁶

Reliance damages. If the plaintiff cannot prove the profit which would have resulted from performance of the contract, the plaintiff may be able to recoup expenses incurred in partial performance of or in preparation for the contract. These are described as damages for wasted expenditure or “reliance damages”.

23. [1957] 2 QB 117.

24. Swanton, J and McDonald, B *The High Court on exemplary damages* (1999) 73 ALJ at p 405.

25. *Robinson v Harman* (1848) 1 Ex 850 at p 855; (1855) 154 ER 363 at p 365. In

comparison, the purpose of an award in tort is to place P in the position P would have been in had the tort not happened: ¶4-180.

26. eg Recent cases, *Breach of contract and the expectation interest* (1995) 69 ALJ 32.

— *Case example* —

The Commonwealth Government (D) contracted with Amann Aviation (P) for regular aerial observation of Australia's northern coastline from near Broome to Cairns, mainly for quarantine purposes to detect and report vessels, unauthorised landings, etc. Surveillance flights on the first day were inadequate because P's aircraft were not fully ready in various minor ways. Only seven of the eleven planes contracted for were ready. As a result D terminated the contract for non-compliance. Because D's termination was not in the method set out in the contract, P considered that the termination was ineffective and that it amounted to a repudiation of the contract which entitled P to terminate the contract and to sue for damages (¶6-320).

The Full Federal Court held that because P had not repudiated the contract to deprive D of its benefit, D was not entitled to terminate. The contract clauses in question were innominate terms (¶6-095): even though described as conditions, they were restricted, so D could not rescind for what were considered to be inconsequential breaches.

The High Court rejected D's argument that P's damages should be calculated on the ordinary basis of loss of profits (which in this case would have been nil, as there was to be a loss on the initial contract — P's profits would have come from the hoped-for renewed contract). For this reason, the trial judge awarded modest damages. In contrast, the High Court awarded some \$6.6 million "reliance damages" to P, representing its wasted expenditure in acquiring and equipping aircraft for the contract, holding that because P had not repudiated the contract to deprive D of its benefit, D was not entitled to rescind.

— *The Commonwealth of Australia v Amann Aviation Pty Ltd*²⁷ —

¶6-460 Damages for disappointment and distress. As mentioned in ¶6-380, the basic aim in breach of contract cases is to compensate the injured party. When people contract, they can estimate liability in the event of default, but they cannot estimate subjective mental reactions to breach of contract. For this reason, the courts generally did not award damages for injured feelings, disappointment or distress as a result of breach of contract.²⁸

— *Case example* —

When P was dismissed from employment in circumstances considered harsh and humiliating, P was not entitled to damages from his former employer for breach of contract in respect of his injured feelings and loss of employment prospects resulting from the manner of his dismissal.

— *Addis v Gramophone Co Ltd*²⁹ —

27. (1991) 174 CLR 64; (1991) 66 ALJR 123, noted (1992) 66 ALJ 460, Seddon, N, *Contract damages where both parties are at fault* (2000) 15 JCL 207; ¶6-320. Contract clauses even though described as conditions (¶6-095) were restricted by

the Full Federal Court, so D could not rescind for inconsequential breaches by P.

28. In contrast to recovery of exemplary damages in tort: ¶4-200.

29. [1909] AC 488; [1908-10] All ER Rep 1.

This general rule is subject to many exceptions. Hence, damages for injured feelings, anxiety, disappointment and distress can be recovered for breach of contract as follows:³⁰

- (1) where the defendant's breach of contract has caused physical injury to the plaintiff;
- (2) which includes compensation for physical inconvenience (such as that caused when a train fails to stop at a station);
- (3) which includes mental suffering directly related to the physical inconvenience, and
- (4) where the object of the contract was to provide pleasure or relaxation.

— *Case examples: class (4)* —

P booked a two-week package tour in Switzerland, described as "Swans houseparty in Moorlialp". The holiday was a dim reflection of its description in D's advertising brochure, and P sued for damages for breach of contract. On appeal it was held that P was entitled to damages for disappointment, etc. Earlier narrow authorities, which only allowed recovery where there was physical inconvenience as well, were rejected.

— *Jarvis v Swans Tours Ltd*³¹ —

P was allowed recovery not only for his discomfort and distress due to breach of contract but also for the discomfort and distress suffered by his wife and children, where it transpired that the travel agent's glowing description of accommodation and facilities turned out to be grossly wrong.

— *Jackson v Horizon Holidays Ltd*³² —

A cruise ship passenger, Mrs Dillon, was awarded \$5,000 for disappointment and distress consequential upon physical inconvenience when the cruise ship sank off New Zealand.

— *Baltic Shipping Company "The Mikhail Lermontov" v Dillon*³³ —

¶6-470 Damages recoverable: difficulty in assessment. The mere fact that the calculation of the amount of damages to be awarded to a plaintiff is difficult is not ground for disallowing the damages: "the ascertainment of damage is not an exercise in imagination. It is therefore necessary to examine the material in order to see what assumptions are involved and, in so far as they are not justifiable, to see whether adjustments can be made which would enable a reasonable approximation to be obtained."³⁴

30. *Baltic Shipping Company "The Mikhail Lermontov" v Dillon* (1993) 176 CLR 344 at pp 362-363; (1993) 67 ALJR 228, per Mason CJ (as he then was) at p 238; ¶6-220. For exemplary damages in equity, compare ¶6-417.

31. [1973] QB 233; principle of damages for loss of enjoyment of holidays also applied

in tort cases such as *McCreary v Whitney* (1990) Aust Torts Reports ¶81-004.

32. [1975] 1 WLR 1468.

33. (1993) 176 CLR 344, noted (1993) 67 ALJ 379; ¶6-220.

34. *Air Express Ltd v Ansett Transport Industries (Operations) Pty Ltd* (1981) 146 CLR 249 at p 284.

— *Case example* —

Because of the defendant's breach of contract, P was unable to enter D's beauty competition. P was awarded damages as D had denied her the opportunity to be considered in the competition. P's claim for damages was not too remote and was analogous to the valuation of a contingent claim in bankruptcy.

*Chaplin v Hicks*³⁵ —

This case is a precedent for the law to provide for recovery in respect of lost business opportunities. It has also been applied in tort cases involving negligent advice claims against solicitors. The loss of a chance of economic gain may therefore be recovered in damages in tort or contract.³⁶

— *Case example* —

P was a horse trainer who had leased a racehorse called Sankip from D for a period of three years. Six months after the contract was entered into, D breached it by taking the horse back. P sued successfully for the loss of profits he would have made on his bets.

*Howe v Teefy*³⁷ —

¶6-475 Contributory negligence as a defence to actions for breach of contract. Contribution legislation allows a court to apportion damages recoverable in tort actions according to the fault of the respective parties (¶4-160).

The High Court has now held that the apportionment legislation does not apply to actions framed in contract. However, it may operate where there is solely liability in tort.³⁸

¶6-480 Damages recoverable: mitigation. Where one of the parties breaches the contract, the other may sue for the breach and will generally recover damages sustained by that breach. However, as well as giving the injured party the right to sue, the law imposes on the injured party the duty to mitigate its losses, ie to do everything reasonable to minimise the losses (as in tort: ¶4-200). Thus, in a case like *Brace v Calder*³⁹ a person discharged from employment would be obliged to minimise the losses by accepting a reasonable offer of new employment in a similar type of job or else be limited to "nominal" damages only.

35. [1911] 2 KB 786.

36. *The Commonwealth of Australia v Amann Aviation Pty Ltd* (1991) 174 CLR 64, ¶6-455.

37. (1927) 27 SR (NSW) 301; ie the chance must have some assessable economic value; the injury caused must be of a legally compensable kind.

38. *Astley v Austrust Ltd* (1999) 73 ALJR 403, ¶4-160. See further Swanton, J and McDonald, B, *Concurrent liability in tort and contract — professional negligence — contributory negligence* (1999) 73 ALJ 541.

39. [1895] 2 QB 253; [1895-99] All ER Rep 1196.

However, the duty of mitigation of damages placed on the plaintiff (injured party) is not as stringent as it may appear to be. For the burden of proof lies on the defendant to prove that the plaintiff has failed to mitigate the losses, not on the plaintiff to prove mitigation.

— *Case example* —

The seller agreed to sell to the buyer 200 pieces of crepe de chine which were to be delivered in instalments over a period of nine months. The buyers agreed to pay for each instalment within one month of delivery. The buyers failed to make timely payment for the first delivery and although the seller felt he was entitled to treat this conduct as sufficient breach to allow him to repudiate the entire contract, he offered to continue to make the monthly delivery of the goods providing the buyers agreed to pay cash for each such delivery. The buyers rejected this offer. After the price of these goods rose, the buyers sued for breach of contract.

The court held that in the circumstances the seller was not warranted in treating the buyers' breach as a ground for repudiating the entire contract, and thus the seller was liable for damages. However, the court also held that the buyers should have mitigated their damages by accepting the seller's new proposal for COD deliveries. The court stated that the damages to be allowed the buyers, in the circumstances, were to be measured by the loss they would have sustained had they accepted the seller's COD proposal, and not by the difference between the contract price and the market price. *Scrutton LJ* said:

"In commercial contracts it is generally reasonable to accept an offer from the party in default."

— *Payzu v Saunders*⁴⁰ —

¶6-490 Damages recoverable, both liquidated and unliquidated: penalties. A plaintiff suing for a breach of contract can sue for either "liquidated" or "unliquidated" damages, or both; they are not exclusive classifications.

When the plaintiff is not able to sue for a precise, fixed sum (liquidated damages) but must let the court or jury assess the recoverable damages, the damages are said to be unliquidated. The damages sought by the plaintiffs in *Payzu v Saunders*⁴¹ (¶6-480) and in *Howe v Teefy*⁴² (¶6-470) are examples of claims for unliquidated damages. However, if the plaintiff is able to sue for a specified sum, for example the price of goods sold and delivered, or the price or sum specified in the contract as being the sum payable by way of pre-estimation of damages in case of a breach, then the claim will be for liquidated damages.

40. [1919] 2 KB 581 at p 589.

42. (1927) 27 SR (NSW) 301.

41. [1919] 2 KB 581; [1918-19] All ER Rep 219.

Cotton LJ in *Wallis v Smith*⁴³ defined liquidated damages as follows:

“liquidated damages means that it shall be taken as the sum which the parties have by the contract assessed as the damages to be paid, whatever may be the actual damage.”

For example, building contracts often provide for the payment of damages at a certain rate or amount if the building is not completed on time. If the stipulation in the contract is genuine, ie is a genuine estimate of what the loss is likely to be, then the defaulting party would be obliged to pay such sums without the injured party having to prove the actual damage. The injured party's claim would be for liquidated damages. Where the sum specified is so extravagant as not to bear any reasonable relationship to damages which might be expected to flow from a breach, the court will interpret the provision as a penalty provision rather than a liquidated damage provision and it will not be enforceable.

The traditional view in judging whether a clause provides a penalty or a genuine pre-estimate of loss is to contrast the clause with the loss recoverable at law for breach of contract under the two limbs in the “rule in *Hadley v Baxendale*”, namely, damage flowing “naturally” and such exceptional damage as was in the contemplation of the parties (§6-430).

The modern view, as confirmed by the High Court, allows the parties to determine their own contract by upholding the validity of penalty clauses subject to the rules of equity and the common law:⁴⁴

“Instead of pursuing a policy of restricting parties to the amount of damages which would be awarded under the general law or developing a new law of compensation for plaintiffs who seek to enforce a penalty clause, the courts should give the parties greater latitude to determine the terms of their contract. In the case of provisions for agreed compensation and, perhaps, provisions limiting liability, that latitude is mutually beneficial to the parties. It makes for greater certainty by allowing the parties to determine more precisely their rights and liabilities consequent upon breach or termination, and thus enables them to provide for compensation in situations where loss may be difficult or impossible to quantify or, if quantifiable, may not be recoverable at common law. And they may do so in a way that avoids costly and time-consuming litigation. But equity and the common law have long maintained a supervisory jurisdiction, not to rewrite contracts imprudently made, but to relieve against provisions which are so unconscionable or oppressive that their nature is penal rather than compensatory ... [cf §5-730] ... The doctrine of penalties answers, in situations of the present kind, an important aspect of the criticism often levelled against unqualified freedom of contract, namely the possible inequality of bargaining power. In this way the courts strike a

43. (1882) 21 Ch D 243 at p 267.

44. *AMEV-UDC Finance Ltd v Austin* (1986)
162 CLR 170, per Mason and Wilson JJ
at pp 193-194.

balance between the competing interests of freedom of contract and protection of weak contracting parties ...”

A contract may specify the interest rate and provide for a higher interest rate if there is default. If the higher rate can be analysed as a penalty, the lender will not be entitled to claim the increased rate.

A higher rate is not a penalty and is effective if:

- the increased rate is only prospective — from the time of default, and/or
- the lender has specified a higher rate and a lower rate, and has provided that where the borrower pays the interest on time, interest is payable at the lower rate not the higher rate. If default occurs, the higher rate or default rate only becomes payable from the date of default and not retrospectively to the commencement of the finance.⁴⁵

A large increase in the default which is calculated retrospectively upon breach may be unenforceable as a penalty.

— *Case example* —

A prime mover was leased by P (the lessor) to D (the lessee, a cartage contractor) for 36 months for an “entire rental” of \$39,550 due on the signing of the agreement to be paid by monthly instalments of \$1,099. The lease contained a proviso that if the lessee’s obligations under the lease were in order and if monthly instalments were up to date, the lessor would not enforce payment of the entire rent. The lease also provided that in the event of default, the lessor could repossess the vehicle, and that all instalments due for the unexpired term would be payable immediately. When the lessee defaulted after seven months, the lessor repossessed the vehicle and sold it for \$20,000. The lessor then claimed \$31,440 (the difference between the total rent and the instalments paid) and other amounts owing or, alternatively, damages of \$33,650.

The High Court held that the lessee was not liable for the amount owing under the lease for the period after repossession as this was a penalty and not a genuine pre-estimate of damage. At the date of the contract, there was only an obligation to pay instalments and there was no presently existing obligation to pay the entire rent. Because the lessor’s right to the balance of the rent instalments for the unexpired term (with no rebate) only arose on default, it was held to be unenforceable as a penalty, and the lessor was restricted to its actual loss.

— *O’Dea v Allstates Leasing System (WA) Pty Ltd*⁴⁶ —

Acceleration of payment in the following three examples given in the *O’Dea* case does not involve a penalty because the acceleration is based on

45. Section 28 of the Consumer Credit Code permits a higher rate of interest on default, but only on the amount in default while the default continues: ¶14-170.

46. (1983) 152 CLR 359 at pp 366-367, noted (1983) 57 ALJ 580.

a present debt which has been varied with the consent of the creditor if certain conditions are met. The failure of the condition does not entitle the creditor to damages, because the result of the default is that the sum that was always owed becomes recoverable at once or in full:

- where a sum of money is payable by instalments, and the contract provides that in the event of one instalment not being paid on time the whole sum becomes payable;
- an agreement to charge a certain rate of interest on condition that if payment is made on time, the rate will be reduced; and
- an agreement by a creditor to accept part payment in full discharge if certain conditions are met but which stipulates that if the conditions are not met, the creditor will be entitled to recover the original debt.

Hence a contract which provides for payment by instalment may legally provide that on default of one instalment the balance of the instalments becomes due and payable. A loan agreement may provide that on default the interest rate is to be increased from the date of the default. Such acceleration is not classed as a penalty unless a different or additional obligation is imposed on the debtor. If the instalment payments were made for a service, and if the contract provided for continued payment even after the service was terminated by breach, the payments would be in the nature of a penalty. Similarly, a default clause giving the lessor the right to terminate for serious or trivial breaches and to sue for the unpaid balance of rent less a rebate for outstanding rent of 10% failed to qualify as a genuine estimate of the lessor's damages and had no effect as a penalty.⁴⁷

¶6-500 Loss of right to sue. The right to sue for a breach of contract either at law or in equity may be lost, for example through the operation of Statutes of Limitation or the equitable doctrine of laches.

The time within which one must commence legal action to enforce one's rights is limited by Statutes of Limitation. These statutes protect a person from being forced to defend a law suit brought after a certain period of time. The law requires that if a person has a valid claim against another, action to enforce that claim should be brought within a certain period. Otherwise the other person may be treated unfairly, because of inability to obtain the necessary evidence to substantiate a defence, and any possible witnesses may be dead, unavailable or have forgotten all the facts.

The Statutes of Limitation are a defence, a shield behind which one may hide after the passing of the specified period and be safe from any action by the other party. They do not extinguish the obligation nor do they make it void. They merely render it unenforceable unless the defendant does something to waive this defence given by the law. For a cause of action in debt, a part payment of the debt would act as a waiver; or where there are several accounts

47. *Citicorp Australia Ltd v Hendry* (1985)
4 NSWLR 1; ¶13-370.

with the same creditor, making a payment without specifying that the payment is for debts not statute barred would have the same result. If the debtor should acknowledge the debt in writing after the statute has run, the debt itself is said to be revived and a new period of limitation begins to run.

The period of limitation begins to run as soon as a cause of action arises, eg when the breach of contract occurs. For simple contracts that period of limitation is six years (three years in the Northern Territory); for contracts under seal the period is, generally, twelve years.⁴⁸

Three equitable defences may be used to defeat a claim — laches (inaction in enforcing a right), acquiescence (assent to infringement of rights) and delay (the period of inaction) — because long delays in enforcing one's rights tend to prejudice the other party.⁴⁹

¶6-510 Restitution. Restitution means restoration. The remedy of restitution is to reverse enrichments gained at the expense of others, and to require the defendant to restore to the plaintiff:

- money equal to the amount received from the plaintiff, or
- payment for goods or services received from the plaintiff.

‘[T]he importance of the concept of unjust enrichment in the law of this country ... [is as] ... a unifying legal concept which explains why the law recognises, in a variety of distinct categories of case, an obligation on the part of a defendant to make fair and just restitution for a benefit derived at the expense of a plaintiff and which assists in the determination, by the ordinary processes of legal reasoning, of the question whether the law should, in justice, recognise such an obligation in a new or developing category of case ...’⁵⁰

Restitution can be claimed whether or not there is a contract, although it will not usually be awarded if there is a contract between the parties — their remedy would normally be in damages for breach of contract. Restitution is not possible if the plaintiff's claim was prohibited by contract.⁵¹

To ground a claim for restitution on the basis of unjust enrichment, there are four tests:

48. Simple v formal — see NSW: *Limitation Act 1969*, sec 14 and 16; Vic: *Limitation of Actions Act 1958*, sec 5(1) and 5(3) (deed: 15 years); Qld: *Limitation of Actions Act 1974* sec 10; SA: *Limitation of Actions Act 1936*, sec 34, 35; WA: *Limitation Act 1935*, sec 38; Tas: *Limitation Act 1974* sec 4; ACT: *Limitation Act 1985* sec 11; NT: *Limitation Act 1981*, sec 12, 14; ¶5-030.

49. Discussed in *Orr v Ford* (1989) 167 CLR 316; (1989) 63 ALJR 198 per Deane J, noted (1990) 64 ALJ 103.

50. *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221, per Deane J at pp 256-257. The remedy of restitution includes all claims, including the earlier remedy of “quasi-contract”, based on unjust enrichment. See generally Goff, Lord and Jones, G, *The Law of Restitution*, London, Sweet and Maxwell, 5th ed, 1988; Jackman, IM, *The Varieties of Restitution*, Sydney, Federation Press, 1998.

51. eg *Sunstar Fruit Pty Ltd v Cosmo* [1995] 2 Qd R 214 at p 227.

- (1) Was there a benefit and an enrichment by D:
 - a positive enrichment such as an increase in wealth to the defendant, or
 - a negative enrichment, such as a saving of an expense by the defendant?
- (2) Was D's enrichment at the expense of the plaintiff?
- (3) Was D's enrichment unjust — ie based on factors such as failure of consideration, mistake, duress, compulsion and/or illegality?
- (4) Are there any defences such as estoppel, change of position, purchase in good faith, illegality and/or incapacity?

Restitution of money paid under a mistake of fact or law, such as overpayment, payment by a bank to the wrong person (¶16-470; ¶16-540) or, as in the *David Securities case* (1992), payments to a bank which are void under tax law (¶5-686).⁵²

Restitution of money paid under an ineffective contract. Where D completely fails to perform contractual obligations, or where the contract is unenforceable for non-compliance with the *Statute of Frauds* (¶5-030), or where the contract is void *ab initio* such as for minority (¶5-520), mistake (¶5-620ff), public policy or possibly under statute (¶5-827), P can recover what has been paid as on a total failure of consideration so long as P has received no benefit under the contract.⁵³ This is not a claim in contract, but is a claim for restitution based on an action in unjust enrichment. It was originally based on the old count of "money had and received". In the *Trident Insurance case*, *Gaudron J* upheld the right of the third party C to claim on the A/B insurance contract in restitution to prevent unjust enrichment (of insurer A) (¶6-270).⁵⁴ Restitution and full damages will not be available for the same breach of contract because such claims are alternative, not cumulative.⁵⁵

Restitution of payment as reasonable remuneration on a quantum meruit ("as much as he has earned") (¶6-290). If a person provides goods or services but has no contractual right to payment, there may still be a right to payment of reasonable remuneration under a *quantum meruit* — the right to proportional payment for as much of the goods or services as has been provided.

A *quantum meruit* may arise under contract, for example where no precise sum has been fixed. It may arise under quasi-contract, for example where the contract has been discharged by breach, or where the contract is

52. *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353, noted (1993) 67 ALJ 307, ¶16-060.

53. As in *Rowland v Divall* [1923] 2 KB 500; [1923] All ER Rep 270: ¶7-040.

54. eg *Proksh, L, Restitution and privity* (1994) 68 ALJ 188.

55. *Baltic Shipping Company v Dillon* (1993) 176 CLR 344, ¶6-220; *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 WLR 802, noted (1996) 70 ALJ 705.

void or unenforceable, such as for non-compliance with the “memorandum or note” requirement of the *Statute of Frauds* (§5-030). The law of quasi-contract⁵⁶ enables a person to recover payment for goods or services provided in the absence of contract. Recovery in quasi-contract is based on the right of *restitution* for wrongs to supplement actions in contract and tort based on the defendant’s unjust enrichment.⁵⁷

— *Case examples* —

Work was carried out by P and D on the joint assumption that they would enter a contract. When D unilaterally decided to “drop the present scheme” for its own reasons, P was entitled to compensation or restitution from D for its work on a *quantum meruit*.

————— *Sabemo Pty Ltd v North Sydney Municipal Council*⁵⁸ —

A builder was entitled to recovery from a client on a *quantum meruit* for “a reasonable sum” even though the building contract was technically unenforceable because it did not comply with builders’ licensing legislation. (The contract was oral, and the legislation required written building contracts.) The High Court held that the *quantum meruit* claim was not based on implied contract, but was based on restitution or unjust enrichment because of the client’s acceptance of benefits from the builder’s performance of the unenforceable oral contract:

“There is no apparent reason in justice why a builder who is precluded from enforcing an agreement should also be deprived of the ordinary common law right to bring proceedings on a common indebitatus count to recover fair and reasonable remuneration for work which he has actually done and which has been accepted by the building owner: cf *Johnsons Tyne Foundry Pty Ltd v Maffra Corporation*.^[59] Nor, upon a consideration of the words of [the section] in their context in the Act, am I able to identify any legislative intent to deprive the builder of that ordinary common law right. The section does not make an agreement to which it applies illegal or void. Nor do its words disclose any legislative intent to penalise the builder beyond making the agreement itself unenforceable by him against the other party.”

————— *Pavey & Matthews Pty Ltd v Paul*⁶⁰ —

A client decided not to proceed with a proposed superannuation scheme. The superannuation consultants were entitled to their fee in restitution for reasonable costs and expenses for work done towards setting up the scheme.

56. An abbreviation of *quasi ex contractu* (Latin): as if upon a contract.

57. Although the current view is that quasi-contract is based on the right to restitution, the origins of quasi-contract are debatable and are said to be based on Roman Law, principles of natural justice, or an implication of an implied contract to reimburse.

58. [1977] 2 NSWLR 880.

59. (1948) 77 CLR 544 at p 565.

60. (1987) 162 CLR 221; (1987) 61 ALJR 151, per Deane J at CLR p 262, ALJR p 168; cited eg *Fitzgerald v FJ Leonhardt Pty Ltd* (1997) 71 ALJR 653 at p 661; ¶5-825. An obligation on *quantum meruit* will not be superimposed on a valid contract: *Christiani & Nielsen Pty Ltd v Goliath Portland Cement Co Ltd* (1993) 2 Tas R 122.

No implied term to this effect was required. There was no evidence that the consultants were to be paid “only if” the scheme went ahead, and no element of wrongful repudiation had to be shown.

_____ *Independent Grocers Co-operative Ltd v Noble Lowndes Superannuation Consultants Ltd*⁶¹ —

A building society alleged that it had lent funds to a borrower on the basis of misrepresentation. It failed to recover the funds from its solicitors in restitution. The solicitors had carried out their instructions, had accounted for the funds, and had not been enriched. Neither misrepresentation nor mistake gave rise by itself to an obligation to make restitution.

_____ *Portman-Building Society v Hamlyn Taylor Neck*⁶² —

A *quantum meruit* is not available to a party in breach of contract. For example, as in *Sumpter v Hedges* (¶6-290), if a contract is an entire contract for a lump sum and if only part of the contract is carried out, the plaintiff cannot recover part payment under the contract or on a *quantum meruit*.

61. (1993) 60 SASR 525.

62. [1998] 4 All ER 202, noted (1998) 72 ALJ 935.

Chapter 7

Consumer Law

Important Note: On 6 November 1995, the Trade Practices Commission (TPC) merged with the Prices Surveillance Authority (PSA) to become the Australian Competition and Consumer Commission (ACCC). All references to the former authorities (including case citations) should be read as references to the ACCC from that date.

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INTRODUCTION

¶7-010 The role and rise of consumer law. Organised advertising had no part to play in the economy of strictly local communities, when people's needs were supplied from the direct labour of their family or domestic units. From an agrarian society, modern industrialised nations have moved to a society predominantly urbanised where simple wants and needs have been replaced with mass marketing and mass consumption. It is in this context, and the context of a technological revolution reflected in the production of highly complex products, consumable and non-consumable, that consumer law has developed.

This chapter is set out as follows:

1. The first part, Sale of Goods Acts, analyses the legal requirements of the Sale of Goods Acts of each State and Territory, and parallel provisions in the *Trade Practices Act*. This legislation makes certain requirements as to fitness for purpose and merchantability virtually compulsory in consumer contracts (¶7-012—¶7-205).
2. Product liability laws. The second part of the chapter analyses the overlapping remedies against manufacturers for defective or unsafe goods or services (¶7-206—¶7-215).
3. The third part of the chapter analyses the “unfair practices” caught by the *Trade Practices Act* (¶7-216—¶7-495). Parallels in other jurisdictions are noted. (Remedies under the Act are discussed at ¶8-750—¶8-930.)
4. The fourth part of the chapter provides an introduction to the legal recognition given to Industry Codes of Conduct by the *Trade Practices Act* (¶7-500).
5. Amendments to the *Trade Practices Act* in 1999 to catch price exploitation under the GST are discussed at ¶7-505.
6. Car traders legislation. This part considers the specific legislation aimed at second hand motor vehicle sales. This body of legislation, largely a product of the 1970s, attempts to ensure that the purchase of a second hand car — and indeed the car itself — will be trouble free (¶7-510—¶7-640).
7. Small Claims Tribunals and other court substitutes. In addition to the easy access to the legal system provided by Small Claims Tribunals, a number of other specialist tribunals are available for consumer redress (¶7-690—¶7-730).
8. Consumer law has no effect if it remains unenforceable and out of reach. This part examines some of the methods of increasing access to the court system through such matters as legal aid and class actions (¶7-750—¶7-860).
9. Consumer Affairs Bureaus. Each State and Territory has a bureau to oversee the market place, and access to this form of government

assistance can provide for conciliation and negotiation between the parties. Voluntary organisations can also provide similar benefits through such methods as publicity, consumer testing and consumer representation (§7-870—§7-930).

10. The effect of media exposure, peer group pressure and other sources of extra-legal redress are considered at §7-940.

SALE OF GOODS

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Interplay between legislation	§7-012
Scope of the Sale of Goods Acts	§7-015
Transfer of property from seller to buyer	§7-020
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Seller's duty to sell goods that correspond with description	§7-060
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Countering exclusion clauses: <i>Consumer Transactions Act 1972 (SA)</i>	§7-190
Countering exclusion clauses: <i>NSW Sale of Goods Act</i>	§7-200
Countering exclusion clauses: <i>Victorian Goods Act</i>	§7-205

§7-011 Overlapping consumer remedies. Consider an injury caused by a product. A person consumes contaminated ginger beer. A child's toy snaps and injures the child. The brakes in a car fail. There are overlapping laws at common law (negligence, contract) and under statute at the

Commonwealth and State/Territory levels which apply to manufacturers and retailers in different situations.

Parallel and alternative remedies include:

- (1) *Negligence*. Is there negligence at common law? Refer to ¶4-060ff; ¶7-208.
- (2) *Contract*. Is there a contract with the retailer? Refer to ¶7-206, ¶7-210. (To sue in contract, privity of contract between the consumer and the retailer must exist (¶6-260).)
 - If there is a contract, is there a breach of a term implied by the *Trade Practices Act* or the *Sale of Goods Act* of each State/Territory? (¶7-035ff) If so, does the *Trade Practices Act* or the *Sale of Goods Act* apply, or both? Refer to ¶7-012.
- (3) *No contract*. If there is no contract with the retailer — eg there is no privity of contract (¶6-260) — can the consumer bypass the retailer and sue the manufacturer and importer direct under *Trade Practices Act* Part V Div 2A (sec 74A-74L)? Refer to ¶7-012, ¶7-206, ¶7-212.
- (4) *Misleading or deceptive conduct*. Is there misleading or deceptive conduct under sec 52 of the *Trade Practices Act* and *Fair Trading Act* equivalents? Refer to ¶7-250.
- (5) *Product standard*. Is there a breach of a product safety standard and/or a product information standard under *Trade Practices Act* Part V Div 1A (sec 65B-65T) and equivalents in some States/Territories? Refer to ¶7-495.
- (6) *Defective or unsafe goods*. At the most extreme level, is the injury caused by an unsafe product? If so, liability is imposed under *Trade Practices Act* Part VA (sec 75AA-75AS): refer to ¶7-206, ¶7-215.

¶7-012 Interplay between legislation. Each State has legislation governing the sale of goods, and its operation is discussed below. In addition, terms and conditions are implied in certain situations by the *Trade Practices Act*, Part V Div 2 and 2A, and this legislation is also discussed.

The State/Territory legislation:

- does not operate Australia-wide, as it is limited to State/Territory borders;
- applies to all sellers, as it is not limited to corporations or the other powers of the Commonwealth (¶7-220);
- can be overridden by the *Trade Practices Act 1974* (Cth) if relevant. Section 109 of the Commonwealth Constitution provides that if a State law is inconsistent with a Commonwealth law, the State law will be invalid to the extent of the inconsistency (¶1-475).
- is administered by State/Territory governments and does not involve the ACCC (a Commonwealth agency).

While the Sale of Goods Acts may appear to overlap the *Trade Practices Act* provisions and to contain parallel provisions, in reality there is a *three-tier* system of regulation of contracts for the sale of goods, etc which has application in different circumstances:

- (1) *Consumer transactions: the Trade Practices Act.* The application of the Act is limited to situations involving corporations, or other persons in certain circumstances (see ¶7-220ff). Non-excludable conditions and warranties are implied into contracts for the supply of goods and services to “consumers”, as defined in sec 4B (¶7-230).¹

A person is a “consumer”:

- (i) if the price of the goods or services is under \$40,000; or
- (ii) where the price is over \$40,000, if the goods or services are for “personal, domestic or household use” or are a “commercial road vehicle”,

and, in the case of goods, they are not acquired for re-supply or for being used up or transformed in business.

Summarised, sec 4B asks whether the goods are acquired to be *used or consumed* (a consumer transaction), or *used up in business* (a non-consumer transaction).

Consider the following examples:

- Consumer: a gardener who buys \$100 worth of sand for her daughter’s sandpit.
- Non-consumer: a gardener who buys \$100 worth of sand for a client’s daughter’s sandpit.²
- Non-consumer: the opening by a bank for a nominal amount (much less than \$40,000) of a line of credit or a cheque account does not make the bank’s customer a “consumer” where the bank’s purpose is to provide a trade finance facility of up to many millions of dollars.³

1. Also, eg, *Australian Securities and Investments Commission Act 1989* (Cth) sec 12BC; *Fair Trading Act 1999* (Vic) (not applicable); 1987 (NSW) sec 5 (no monetary limit); 1987 (SA) sec 48 (\$40,000 etc); 1987 (WA) sec 6 (\$40,000 etc); 1989 (Qld) sec 6 (\$40,000 etc); 1990 (Tas) sec 5 (\$40,000 etc); 1992 (ACT) sec 6 (no monetary limit); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 5 (no monetary limit). See further Clarke, B and Kapnoullas, *The definition of “consumer” in the Trade Practices Act: a guide for the*

perplexed (1993) 1 CCL 10; Latimer, P, *The definition of ‘personal, domestic or household use or consumption’ in the Trade Practices Act* (1998) 6 CCL 45.

2. It is open to speculation whether the gardener is a consumer if she buys the \$200 worth of sand at the same time and it is delivered on the same truck.

3. *Westpac Banking Corporation Ltd v Prelea* (1992) 28 NSWLR 481; (1992) ATPR (Digest) ¶46-093; ¶7-290.

- Consumer: the annual overhaul of a steamship involving services and materials costing \$25,000.⁴
- Consumer: the owner of an executive jet contracting with Qantas for aircraft maintenance.⁵

A right of action against manufacturers and importers of goods is created in respect of the acquisition of goods for personal, domestic or household use or consumption by Part V Div 2A, where the definition of “goods” in sec 74A(2)(a) corresponds with the definition of consumer in sec 4B (¶7-212).⁶ This means that the retailer in a transaction may be by-passed in proceedings to reach the manufacturer or importer, who in reality has control over the standard of the product. The Division operates to overcome the doctrine of privity (see ¶6-260—¶6-270).

These sections take precedence over State legislation within their area of operation. “Goods” and “services” are broadly defined (sec 4).

- (2) *Consumer transactions.* The Sale of Goods Acts of the States and Territories are applicable to contracts made in those States or Territories. Victoria, New South Wales, South Australia, Western Australia and the Northern Territory make separate provision for consumer contracts and impose non-excludable implied conditions into this type of contract.⁷ In each of these Acts there is a definition of a consumer contract by reference to private use, etc along the lines of that in the *Trade Practices Act* noted above (see also ¶7-230). For example, the cut-off point is \$20,000 in Victoria and \$40,000 in South Australia (“consumer contracts”).⁸ There is no monetary limit in the New South Wales or Northern Territory Acts.

The State/Territory legislation:

- does not operate Australia-wide, as it is limited to State/Territory borders;
- applies to all sellers, as it is not limited to corporations or the other powers of the Commonwealth (¶7-220);

4. *Pondcil Pty Ltd v Tropical Reef Shipyard Pty Ltd* (1994) ATPR (Digest) ¶46-134 (¶6-230). The service contract was therefore subject to TPA sec 74 (¶7-095).

5. *Qantas Airways Ltd v Aravco Ltd* (1996) 70 ALJR 590, (1996) ATPR ¶41-486: ¶7-095.

6. Div 2A has been held not to apply to a \$155,000 prime mover: this is not “goods of a kind ordinarily acquired for personal, domestic or household use or consumption” and is excluded by

sec 74A(2)(a): *Minchillo v Ford Motor Company of Australia* (1994) ASC (Digest) ¶56-266.

7. *Goods Act 1958* (Vic) Pt IV; *Sale of Goods Act 1923* (NSW) Pt VIII (“Consumer Sales”); *Consumer Transactions Act 1972* (SA); *Fair Trading Act 1987* (WA) Pt III; *Consumer Affairs and Fair Trading Act 1990* (NT) Pt V Div 2.

8. *Goods Act 1958* (Vic) sec 85; *Consumer Transactions Act 1972* (SA) sec 5.

- can be overridden by the *Trade Practices Act 1974* (Cth) if relevant. Section 109 of the Commonwealth Constitution provides that if a State law is inconsistent with a Commonwealth law, the State law will be invalid to the extent of the inconsistency (§1-475).
 - is administered by State/Territory governments and does not involve the ACCC (a Commonwealth agency).
- (3) *Non-consumer transactions.* Sales outside consumer transactions in classes (1) and (2) above continue to be regulated by the relevant *Sale of Goods Act*. In these situations there is a possibility of exclusion of implied conditions (§7-120).

§7-015 Scope of the Sale of Goods Acts. The law governing the sale of goods (and, in some jurisdictions, the supply of services) is primarily contained in the Sale of Goods Acts based on the original English Act of 1893 which codified the existing common law rules and which has provided the basis for sale of goods legislation through the common law world.⁹

The sale of goods is also governed by overriding Commonwealth legislation if relevant, such as the *Trade Practices Act 1974* (Cth), and taxation law (including sales tax) and company law, and also State/Territory legislation governing motor car traders, fair trading, etc.

The sale of goods legislation does not intend to provide an exclusive code. It expressly preserves the common law including the law merchant and the laws of principal and agent (Chapter 11), fraud and misrepresentation (§5-700—§5-705), duress or coercion (§5-720), mistake (§5-620—§5-690) or other invalidating cause. Equitable remedies such as specific performance (§6-400), injunctions (§6-410—§6-415), rescission for misrepresentation (§5-700—§5-705) and unconscionability (§5-730), and the doctrine of estoppel (§5-485) are also preserved by the Sale of Goods Acts expressly or by implication.

What are “goods”? The expression “goods” includes all chattels personal (broadly, moveable property: §3-020) other than choses in action (ie recoverable claims such as debts, patents, trade marks, copyrights, shares, bills of exchange, insurance policies) or money. The term includes emblements (industrial crops — wheat, potatoes, hay) and things attached to and forming part of the land which are agreed to be severed before sale or under the contract of sale. The sale of a fixture (which is a thing affixed to or forming part of land — real property: §3-080—§3-100) will be regulated by sale of goods legislation if it is to be “severed” and sold as goods. Music is not in itself goods or a merchantable commodity until it

9. *Goods Act 1958* (Vic); *Sale of Goods Act 1923* (NSW); *Sale of Goods Act 1896* (Qld); *Sale of Goods Act 1895* (SA); *Sale of Goods Act 1895* (WA); *Sale of Goods Act 1896*

(Tas); *Sale of Goods Act 1954* (ACT); *Sale of Goods Act 1972* (NT). This State/Territory legislation must be read subject to the *Trade Practices Act 1974* (Cth).

is recorded or published. Similarly, a lecture is not goods, but it is when the lecturer publishes it in a book. Computer equipment installed before sale may be a fixture rather than goods, especially if extensively bolted and wired in. Computer software, despite its inherent intellectual characteristics, is generally accepted as goods.¹⁰

A contract for *work and materials* will not be regulated by sale of goods legislation.

— *Case example* —

A commission to paint a portrait was analysed as a contract for work and materials, not a contract for the sale of goods. The judge differentiated between “the production of something to be sold” which was a sale of goods, and the contract which had as its substance skill and labour, with an “ancillary” passage of materials. The latter was defined as a contract for “work and labour and materials” to which the *Sale of Goods Act* did not apply.

— *Robinson v Graves*¹¹ —

Classifying goods. Different kinds of goods are referred to in the Sale of Goods Acts:

(1) “Existing goods” are those owned or possessed by the seller at the time of sale. They may be specific or unascertained (later becoming ascertained).

(a) “Specific goods” are goods identified (not merely identifiable) and agreed upon at the time a contract of sale is made: eg A agrees to sell its widget to B.

(b) “Unascertained goods” are goods not identified or agreed upon at the time the contract is made, such as an agreement to buy a new car of a certain model from a car dealer. Unascertained goods can be of three types:

(i) goods to be manufactured or grown, ie “future” goods;

(ii) generic goods of a class as described, such as 100 tonnes of sugar;

(iii) “quasi-specific” goods — an unidentified part (generic) of a specific whole, such as 100 tonnes of sugar from my store at Bundaberg.

(c) “Ascertained goods”. Unascertained goods become ascertained when the parties agree which specified goods are to become specific and identified as the existing goods forming the subject of the contract.

10. So held in *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd* [1983] 2 NSWLR 48 (computer system a sale of goods); *Advent Systems Ltd v Unisys Corporation* 925 F 2d 670 (1991) (computer software is goods, the sale of

which is regulated by the sale of goods legislation, not by intellectual property law). Electronic share market information not goods: cf *ASX case*, ¶8-660.

11. [1935] 1 KB 579 at p 587.

(2) "Future goods" means goods to be manufactured or acquired by the seller after the making of the contract for sale.

Contract for the sale of goods. The Acts regulate sales and agreements to sell. They define a contract for the sale of goods as "a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration called the price. There may be a contract of sale between one part owner and another." A contract of sale is defined to include an "agreement to sell", ie where the transfer of the property (the ownership, as intended in the original 1893 definition) in the contract is to take place at a future time or subject to the fulfilment of some condition (condition precedent: ¶6-060).

A contract for the sale of goods can be made in writing (whether by simple contract or by deed (¶5-040); by word of mouth; partly in writing and partly by word of mouth; or it may be implied from the conduct of the parties. However, although such a contract can be made in any form, there is one important formality in some jurisdictions in the case of a contract for the sale of goods above a certain value. In force and not indexed since 1677, and set out at ¶5-030, the *Statute of Frauds 1677* (Imp) (re-enacted in some sale of goods legislation)¹² provides that a contract for the sale of goods for \$20 and upwards in Western Australia and Tasmania (\$50 in the Northern Territory) is not legally enforceable unless it is evidenced in writing, or the buyer accepts part of the goods and receives the same, or the buyer gives something "in earnest" to bind the contract or in part payment.

Sale of goods legislation regulates a contract for the "sale" of "goods" (as defined) and any transaction which is not such a contract falls outside the scope of the legislation. There have been many cases argued on the scope of these expressions in the sale of goods context. A contract for the sale of goods is a contract whereby the seller transfers or agrees to transfer the property in the goods to the buyer for a money consideration called the price; thus the transaction must involve (1) a contract, (2) goods, and (3) a price.

If the consideration is the transfer of other goods, the transaction may be treated as one of exchange or barter rather than as one of the sale of goods. The price may be fixed by the contract or may be left to be fixed in a manner agreed or it may be determined by the course of dealing between the parties. Where there is no fixed or determinable price, the buyer must pay a reasonable price. See further ¶5-400ff.

The legislation preserves the common law distinction between contractual terms which are major (conditions) and those of lesser importance (warranties) (¶6-050).

12. *Sale of Goods Act 1895* (WA) sec 4; 1896 (Tas) sec 9; 1972 (NT) sec 9 (¶5-030).

¶7-020 Transfer of property from seller to buyer. It is important in contracting to know exactly when ownership of goods (or in legal terms title to goods, or property in goods) has been transferred from buyer to seller. The time of transfer is especially important because ownership of goods can be transferred separately from payment and their physical delivery, and because:

- risk of loss or damage usually passes with ownership;
- if ownership has passed, the seller can only sue for the price, and cannot repudiate for breach of condition and claim damages. A buyer cannot reject the goods once ownership has passed;
- if ownership is allegedly passed on to a buyer from a vendor who has no ownership rights, the buyer does not become the owner. In this case, the buyer's rights will be displaced by those of any other legitimate purchaser — one cannot give what one does not have (the *nemo dat* rule: ¶3-270);
- the buyer can sue the seller for conversion of the buyer's goods if the seller wrongfully disposes of them;
- in the event of bankruptcy, property owned by the bankrupt vests in the trustee in bankruptcy (¶13-630).

The legislation provides that where a contract is for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained. Where the contract is for the sale of ascertained or specific goods, the property in them is transferred to the buyer at the time the parties intend to be the transfer time. The legislation provides that for the purposes of ascertaining the parties' intention "regard shall be had to the terms of the contract the conduct of the parties and the circumstances of the case".

In the light of these two principles, the Acts set out a number of rules for determining the parties' intention, in order to determine the time at which ownership of the goods is to pass from seller to buyer.

Rules for ascertaining intention. Where no intention can be spelled out from the terms of the contract, the conduct of the parties and the general circumstances, the sale of goods legislation contains five "rules" or presumptions for ascertaining the intention of the parties as to the time when the property in the goods is to pass to the buyer. The first four rules apply to contracts for the sale of specific or ascertained goods:

(1) Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made. It is immaterial whether the time of payment or the time of delivery, or both, be postponed.

(2) Where there is a contract for the sale of specific goods and the seller is bound to do something for the purpose of putting them in a deliverable state, the property does not pass until such thing is done and the buyer has been given notice that it has been done.

(3) Property does not pass where there is a contract for the sale of specific goods in a deliverable state but the seller is bound to weigh, measure, test or do something else with reference to the goods to ascertain their price, until the act or thing be done and the buyer is notified that it has been done.

(4) Where goods are delivered to the buyer on approval or on "sale or return" or on similar terms, the property in the goods passes to the buyer when the buyer signifies approval or acceptance to the seller or does any other act adopting the transaction. Where the buyer does not signify approval or acceptance to the seller but retains the goods without giving notice of rejection, then the property passes to the buyer:

- if a time has been fixed for the return of the goods, on the expiration of that time, or
- if no such time has been fixed, on the expiration of a reasonable time (what is a reasonable time is a question of fact).

(5) The fifth rule applies where there is a contract for the sale of unascertained or future goods by description. Rule 5(1) provides that property passes to the buyer when goods of that description and in a deliverable state are unconditionally appropriated to the contract by either party with the assent of the other. The assent may be express or implied and may be given either before or after the appropriation is made. By virtue of r 5(2), a seller is deemed to have unconditionally appropriated the goods to the contract where in pursuance of the contract the seller delivers the goods to the buyer or a carrier or bailee (whether named by the buyer or not) for transmission to the buyer and does not reserve the right of disposal.

— *Case examples* —

Ascertained goods: rotten kidneys. Meat distributor and wholesaler P bought a consignment of 600 cartons of frozen ox kidneys from the 1,500 cartons held in cold store by the defendant meat importer (D). The 600 cartons were already outside the cold store on the pavement when P's carrier arrived and presented his delivery order, and during the four hours it took to load them they had thawed and some were dripping. On arrival at P's, the cartons were declared unfit for human consumption. P failed in its action for damages for breach of the implied conditions of merchantable quality (¶7-080) and fitness for purpose (¶7-090) and D succeeded in its claim for the price: title passed under rule (5) (above) when P's carrier arrived and from then the cartons were the property of P (having been "unconditionally appropriated") and at P's risk.

— *Wardar's (Import & Export) Co Ltd v W Norwood & Sons Ltd*¹³ —

Unascertained goods: rotten fish. Fish exporter P contracted to sell D 20 boxes of fish. P sent 190 boxes of fish from its premises by rail, consigned to its own order, with instructions to deliver 20 boxes to P. On delivery, the fish was unfit for human consumption. Because the 20 boxes were

13. [1968] 2 QB 663; [1968] 2 All ER 602.

unascertained at the time and not appropriated to D, ownership and the risk of deterioration remained with P.

*Healy v Howlett & Sons*¹⁴ —

When goods perish. The legislation provides that the contract is rendered void:

- if in the case of a contract for specific goods the goods have perished at the time of the contract without the knowledge of the seller, or
- where there is an agreement to sell specific goods and the goods subsequently perish without the fault of either party and before the risk has passed to the purchaser.

Risk prima facie passes with property. If goods are lost, damaged, destroyed or have deteriorated the question arises as to whether the seller or buyer bears the loss. The general rule is that, prima facie, risk passes with property. This is subject to the proviso that where delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault. There is a second proviso the effect of which is that where the goods are in the possession of one party but at the risk of the other, the party with possession of the goods must take reasonable care of them according to all the circumstances of the situation.

Case example

P purchased, for \$55 per tonne, 130 tonnes of linseed meal held in the defendant seller's store at Moree. Because the contract was an unconditional sale of specific goods in a deliverable state, property passed on the making of the contract under rule (1) (discussed above). However, D failed to deliver on the contracted date, and the meal was later destroyed by a fire in D's store. P had to buy replacement meal at \$85 per tonne because P had resold the meal, and P successfully claimed the \$30 per tonne difference from D. The words of the first proviso to the section that the goods are at the risk of the party at fault (in this case, D) are clear, and D was therefore held liable for the "loss which might not have occurred but for [its] fault".¹⁵

*Allied Mills Ltd v Gwydir Valley Oilseeds Pty Ltd*¹⁶ —

Transfer of title by non-owner. The legal rule that one cannot give what one does not possess is acknowledged in the Sale of Goods Acts in a very narrowly drafted section which states that a buyer from a non-owner obtains no better title than the seller had. However, consider the following exceptions:

14. [1917] 1 KB 337; see further Pearson, G, *The transfer of property in unascertained goods: who owns the wine bottles?* (1997) 71 ALJ 134.

15. Sec 25 (NSW, Vic, Tas, ACT); sec 20 (WA, SA); sec 23 (Qld); sec 24 (NT).

16. [1978] 2 NSWLR 26.

(1) *Estoppel*.

"[Sale by person not the owner] Subject to the provisions of this Act, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell."¹⁷

This section opens by stating the rule that one cannot give what one does not have (the *nemo dat* rule: ¶13-270) while the second part of the section sets out an exception to the rule when it precludes or estops A (the true owner of goods) from denying the authority of B (the seller) to sell them so that a sale by B to C (the innocent purchaser for value) will be good against honest owner A.

By parting with possession, is finance company A estopped from denying retailer B's authority to sell to C? Case law has grafted on to the clear words of the section a proposition that an estoppel against A can only arise where there is a duty of care owed by owner A to innocent purchaser for value C.¹⁸

— *Case examples* —

A Rolls Royce, owned by A (the financier — described in the lease as the "proprietor") and leased to B (described as the "owner"), was sold by B to innocent purchaser C. The court held there was no estoppel of A as there was no evidence of a representation by A that B was entitled to sell the car, or there was no conduct by A which entitled B to create an appearance of ownership and that there were no circumstances giving rise to a duty of care by A to C.

— *Associated Midland Corporation v Sanderson Motors Pty Ltd*¹⁹ —

Where A lent her car to B, A was estopped from denying B's authority to sell it to C (A had permitted B to register it in his own name).

— *Leonard v Elasi*²⁰ —

Later case authority is tending to reject the need for a duty relationship and proof of carelessness as a legal requirement, and, for an estoppel to arise under the section, courts may soon accept the view advanced by many commentators and dissenting judges that the section is only one of estoppel by representation by words or conduct whether or not A was negligent.²¹

Section 26(2) provides that the sale of goods legislation does not affect, for instance, the provisions of the *Factors (Mercantile Agents) Act 1923*

17. Sec 26 (NSW, Tas, ACT, NT); sec 27 (Vic); sec 21 (WA, SA); sec 24 (Qld).

18. eg *Thomas Australia Wholesale Vehicle Trading Co Pty Ltd v Marac Finance Australia Ltd* (1985) 3 NSWLR 452. B sold a car (leased from A) to C: held, A was not estopped from denying B's authority to sell in the absence of a register of lease agreements (cf ¶14-320ff)

and A could therefore recover the car from C.

19. [1983] 3 NSWLR 395.

20. (1987) 46 SASR 495; (1988) ASC ¶55-620.

21. eg Kirby P in the *Marac* case, *op cit*; Millhouse J in the *Leonard* case, *op cit*, with many authorities cited.

(NSW) (or equivalent legislation in other jurisdictions). The factors legislation is discussed below and at ¶11-380.

This law is now qualified by the introduction of motor vehicle securities registers in all jurisdictions for the public registration of title. Financiers and other security holders (A) can register their interest so that purchaser (C) can search the title. An unregistered security interest of A is extinguished if C has purchased in good faith, for value and without notice of A's interest: ¶14-320—¶14-380.²²

(2) *Sale by agent*. Because the sale of goods legislation preserves the rules of common law, including therefore the law of principal and agent, a sale by an agent acting within actual, implied or apparent authority would bind the owner (the agent's principal) in a sale to a third person: ¶11-100—¶11-130.

(3) *Sale by a "mercantile agent" or factor*. A factor or mercantile agent trades in goods for its principal on a commission basis. By the customary course of business, a mercantile agent has possession of the principal's goods, and documents of title, and has authority to buy and sell goods, authority to raise money on them as security, and authority to consign them for the purpose of sale. The factors legislation (¶11-380) protects purchasers from factors acting in good faith as if the factor were actually authorised by the owner to sell:

"[Powers of mercantile agent] (1) Where a mercantile agent is entrusted as such with the possession of any goods or the documents of title to goods, any sale pledge or other disposition of the goods made by him in the ordinary course of business of a mercantile agent shall, subject to the provisions of this Act, be as valid as if he were expressly authorised by the owner of the goods to make the same:

Provided that the person taking under the disposition acts in good faith, and has not at the time of the disposition notice that the person making the disposition has not authority to make the same.

(2) Where a mercantile agent so entrusted continues in possession of goods or of the documents of title to goods, any sale pledge or other disposition, which would have been valid if the entrusting had continued, shall be valid notwithstanding the determination thereof, provided that the person taking under the disposition has not at the time thereof notice of such determination."²³

— Case example —

P entrusted his car to a mercantile agent to sell at a specified minimum price. The mercantile agent sold the car to X (for less — in breach of the agreement). X sold it to Y, who sold it to Z, who sold it to D. All parties purchased the car in good faith. P failed in an action against D in detinue (¶4-020) for return of the car, as D was held to have acquired a good title to the car under the *Factors Act*. P intended to pass property in the car to the mercantile

22. A's breach of its duty to register under the motor vehicles securities register leading to extinguishment of its interest is comparable to A's estoppel against C under the *Sale of Goods Act* for its breach of duty to register owed to C.

23. *Factors (Mercantile Agents) Act 1923* (NSW) sec 5; ¶11-380; eg sec 5 held not to apply in *Sonenco (No 87) Pty Ltd v FC of T* 92 ATC 4704 at p 4734ff.

agent, and gave him the necessary authority to pass property to a purchaser. P's remedy would be against the mercantile agent. (If P's argument that the agent took the car by larceny by a trick (compare ¶12-330) had succeeded, P's consent would have been nullified and the *Factors Act* would not have operated.)

_____*Folkes v R*²⁴ _____

The factors legislation does not extinguish the owner's title if the goods were stolen and had been sold to the purchaser by an agent who was not entrusted with the goods by the true owner. It does not give title to a purchaser from an agent who had come into possession from a thief or a person deriving title from a thief.²⁵

This factors legislation is paralleled by an equivalent section in almost identical terms in the Sale of Goods Acts.²⁶

(4) *Sale under a voidable title*. When the seller has a voidable title (for example, through fraud), and the seller's title has not been avoided at the time of the sale, the buyer in good faith and without notice of the seller's defect of title may get good title to the goods.²⁷ This protection to the buyer is not available if the contract is void (for example for mistake) and therefore a nullity. If voidable (for example for fraud), as in *Phillips v Brooks Ltd* (¶5-680) and *Lewis v Averay* (¶5-685), good title can be transferred by the seller to the innocent pawnbroker and purchaser respectively under the Sale of Goods Acts.

(5) *Special powers of sale*. The legislation provides for several situations where a non-owner can pass to a buyer good title to goods under:

- special common law powers, such as the power of sale of a pledgee (¶13-210) and pawnbroker (¶13-220);
- statutory power of sale, such as a sale of goods seized under a writ of execution by sheriff or bailiff (¶1-435), or the power of an innkeeper to exercise the innkeepers' lien (¶13-280);
- sale by court order.²⁸

(6) *Seller or buyer in possession after sale*. If a buyer allows the seller to continue in possession (or if a buyer has obtained possession of the goods sold or the documents of title before ownership has passed), the seller (or

24. [1923] 1 KB 282. In this case P did not have the registration papers to the car as there was some suggestion that they were lost. A car's registration papers are not considered "documents of title".

25. eg *National Employers Mutual General Insurance Association Ltd v Jones* [1990] 1 AC 24.

26. Sec 30, 31 (Vic); sec 28 (NSW, NT); sec 27 (Qld); sec 25 (SA, WA); sec 30 (Tas); sec 29 (ACT).

27. Sec 29 (Vic); sec 27 (NSW, ACT, NT); sec 25 (Qld); sec 23 (SA, WA); sec 28 (Tas).

28. Sec 26(2)(b) (NSW, Tas, ACT); sec 26(b) (Vic); sec 21(2)(b) (SA, WA); sec 24(2)(b) (Qld); sec 26(2) (NT).

buyer) who disposes of the goods to a third person acting in good faith can pass good title to the goods if there has been:

- a continuity of physical possession of the goods regardless of any private transaction between seller and buyer affecting the seller's title to possession;
- an actual or constructive transfer in the physical possession to the third party.

In disputes between an honest owner A (such as a hire-purchase finance company with ownership of the goods), bailee B (the apparent owner) and bona fide purchaser for value C, whom should the law protect?

— *Case examples* —

Sale by seller in possession: third party protection. Finance company A financed car dealer B's stock in trade through a bailment arrangement known as a "floor plan" or display agreement (§13-350). Under the floor plan, B bought the cars and then put them on floor plan by selling them to A for 90% of B's purchase price. A and B treated this as a sale of the cars to A. B held them as bailee for A, B was authorised to sell them in its own name and upon sale was to pay A the 90% advanced and interest. On the same day as B's authority to sell was withdrawn by A, B sold some of A's cars to auctioneer C. After B went into liquidation, A claimed against C in conversion and detainue for return of the cars. The Privy Council upheld third party protection when it decided in favour of C:

The estoppel section at exception (1) above did not apply in the sale from B to C to give title to C because the sale was not in the ordinary course of business. However, on the basis of the special power of sale section at exception (5) above, title passes to the innocent third person C (the purchaser in good faith and without notice of the sale from B to A).

_____ *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd*²⁹ —

Sale by buyer in possession: third party protection. Motor vehicle wholesaler A agreed to sell eight cars to car dealer B under a contract which specified that ownership remained with A until payment had been made in full. B took delivery of them but did not pay, having entered a floor plan agreement with finance company C. As in the *Pacific Motors case* above, finance company C purchased the cars under the floor plan, and B held them as bailee for it. However, when it was not paid for the cars, A seized them from B. C sued A in detainue and conversion for their return or their value.

The High Court held that A had authorised B to pass title to C before it was paid. When B sold the cars to C under the floor plan, there had been a constructive delivery to C. B, having agreed to buy the cars from A and obtaining A's consent to possession, was able to pass title to C by "delivery or transfer". The High Court confirmed that "delivery" includes constructive or symbolic delivery (where there is no actual change in physical possession).

_____ *Gamer's Motor Centre (Newcastle) Pty Ltd v Natwest Wholesale Australia Pty Ltd*³⁰ —

29. (1965) 112 CLR 192; §13-090.

30. (1987) 163 CLR 236; (1987) 61 ALJR 415.

This area of the Sale of Goods Acts presents uncertainties, and as pointed out by the New South Wales Law Reform Commission:³¹

“First, is it satisfactory for an owner to lose title without any transfer of physical possession of the goods by a buyer in possession?

Secondly, the effect of the High Court’s decision [in the *Pacific Motor Auctions case*] is that if A agrees to sell goods to B, and B sells them to C, C may receive A’s title even though B had no authority to pass title and even if the delivery by B is merely constructive. What, then, is the position of D (a person deceived by B’s physical possession) if B, for example, purports to sell to D? Is a delivery by B made valid by either sec 28(1) or sec 28(2) so as to pass C’s title to D?”

(7) *Sale in “market overt”*. The Act in most jurisdictions protects the title of a purchaser acting in good faith without notice of any defect in title who purchases goods openly displayed in a “market overt” such as a market established by a local council.³² The policy for this is that because of the open display at the market, the true owner has a chance to find goods and to reclaim them.

¶7-025 Performance of the contract. The sale of goods legislation provides that it is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract.

Delivery is defined in the legislation as the voluntary transfer of possession from one person to another. It is not synonymous with the transfer of property nor does it involve (necessarily) the actual physical handling of goods. What constitutes delivery depends on the circumstances of the contract.

The sale of goods legislation sets out five rules governing delivery, namely:

(1) Whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer depends in each case on the agreement made, expressly or by implication, between the parties. If the parties have not made such an agreement, then the place of delivery is the seller’s place of business if there is one and, if not, the seller’s residence. However, if the contract is for the sale of specific goods, which, to the parties’ knowledge when the contract is made, are in another place, then that place is the place of delivery.

(2) Where the contract requires the seller to send the goods to the buyer, but does not fix a time for them to be sent, the seller is bound to send them within a reasonable time.

31. NSW Law Reform Commission, *Sale of Goods, Issues Paper*, IP 5, Sydney, 1988, p 31. Further work in this area moved to the Standing Committee of Consumer Affairs Ministers (SCOCAM) in 1988.

32. Sec 28 (Vic); sec 22 (WA, SA); sec 27 (Tas). There is no market overt in NSW, Qld, the ACT and the NT.

(3) Where at the time of sale the goods are in the possession of a third person there is no delivery by seller to buyer unless and until such third person acknowledges to the buyer that the goods are being held by that person on the buyer's behalf. This is subject to the proviso that nothing in the section should affect the operation of the issue or transfer of any document of title to goods.

(4) Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour: what is a reasonable hour is a question of fact.

(5) Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state must be borne by the seller.

The sale of goods legislation also sets out the procedure where:

- there is delivery of wrong quantities (the buyer can reject the goods, but if the buyer accepts the wrong quantity, the buyer must pay for the goods at the contract rate);
- there is a delivery of mixed goods (the buyer can accept only the goods contracted for and reject the rest, or the buyer can reject the whole);
- there is a delivery by instalment — unless otherwise agreed, the goods must be delivered together and not by instalment; if the contract does provide for delivery by stated instalments which are to be paid for separately, it is a question of fact in each case depending on the contract and the circumstances whether a default (such as one shipment being one widget short) is a breach of warranty (damages: ¶6-050) or a breach of condition (repudiation and/or damages: ¶6-050—¶6-090);
- there is delivery to a carrier; delivery to a carrier is deemed to be delivery to the buyer if the seller is authorised or required to send the goods to the buyer; in the absence of agreement to the contrary, the seller must act in the buyer's interests in contracting with the carrier, arranging insurance, etc, and is answerable for any breaches to the buyer.

Acceptance. It is the buyer's duty to accept goods conforming to the sale of goods contract. In contrast to acceptance in the law of contract (¶5-220), acceptance by the buyer under the sale of goods legislation, meaning transfer of ownership, is deemed to have occurred when the buyer:³³

- (1) intimates acceptance to the seller; or
- (2) does any act in relation to the goods after delivery which is inconsistent with the seller's ownership; or
- (3) retains the goods after a lapse of a reasonable time without intimating rejection to the seller.

33. Sec 38 (NSW); sec 42 (Vic); sec 37 (Qld);
sec 35 (SA, WA); sec 40 (Tas); sec 39
(ACT); sec 37 (NT).

However, the section preceding this provides that the buyer is not deemed to have accepted the goods until the buyer has had a reasonable opportunity of examining them to see whether they conform with the contract.³⁴ Under the section first mentioned, the buyer is deemed to have accepted the goods if doing (1), (2), or (3); under the second mentioned, the buyer is not deemed to have accepted the goods until examination. Case law conflicts on whether a buyer who has accepted goods without examination can later rescind if the goods do not conform. The following case distinguishes English authority and is in line with expected commercial practice:

— *Case example* —

200,000 yoyos were sold by A to B, and before delivery were resold from B to C, with A to deliver to C. As some 80% of C's shipment was defective, B rescinded the entire contract. The court held that even though the goods had been delivered to B and C, the delivery to C was not inconsistent with A's ownership, and delivery was to take place when the goods arrived at the place intended for examination. Hence examination and acceptance/rejection took place at C's premises.

— *Hammer and Barrow v Coca-Cola*³⁵ —

The interplay between these two sections has caused difficulties over the years, and in some jurisdictions the Act has been amended to make clear that sec 38 (the first mentioned) is to be read subject to sec 37 (the second mentioned):³⁶ the buyer is deemed to have accepted the goods (except where sec 37 otherwise applies) when the goods have been delivered and the buyer does any act inconsistent with the ownership of the seller.

In South Australia and the ACT, the misrepresentation legislation³⁷ keeps open a purchaser's right to rescind even after the goods have been accepted by the purchaser under SA sec 35/ACT sec 39.

¶7-030 Remedies for non-performance. The sale of goods legislation gives the unpaid seller rights against both the goods and/or the buyer in the event of default by the buyer.

34. Sec 37 (NSW); sec 41 (Vic); sec 36 (Qld); sec 34 (SA, WA); sec 39 (Tas); sec 38 (ACT); sec 36 (NT).

35. [1962] NZLR 723, noted (1963) 26 MLR 194.

36. NSW, SA, Vic, ACT; Kincaid, P, *Acceptance and examination under the*

amended Sale of Goods Acts (1994) 68 ALJ 515.

37. *Misrepresentation Act 1972* (SA) sec 6(1)(b); *Law Reform (Misrepresentation) Act 1977* (ACT) sec 3(b); eg *JAD International Pty Ltd v International Trucks Australia Ltd* (1994) 50 FCR 378; ¶5-705.

Unpaid seller's rights against the goods. Certain “real” rights³⁸ are available to the unpaid seller, allowing the seller to use the goods as a kind of security for payment including:

- a lien on the goods (§13-280) — the right to retain the goods — for the price while they are still in the possession of the unpaid seller;
- in the case of the insolvency of the buyer, a right of stopping the goods (*in transitu*) after the seller has parted with possession but before delivery to the buyer;
- a limited right of resale — for example, in the above two situations, or if the goods are perishable.

Actions for breach of the contract

Remedies of the seller. In addition to the remedies open to the seller, the legislation provides that the seller has a personal action against the buyer either:

- for the price of the goods, or
- for damages for non-acceptance.

Where there is an “available market” for the goods (an expression referring to the likelihood of resale), the measure of damages is the difference between the contract price (say \$100) and the market or current price (say \$90) at the time the goods ought to have been accepted (ie \$10 damages). If there is no available market, the measure of damages is the contract principle of *Hadley v Baxendale* (§6-430), namely the estimated loss directly and naturally flowing in the ordinary course of events from the buyer’s breach of contract.

Remedies of the buyer. Common law and equitable remedies are provided in the legislation for the assistance of a buyer in the case of non-delivery, delayed delivery, delivery of inferior goods, or other breaches of the contract. These remedies include:

- rejection of the goods;
- an action for damages (including action for breach of warranty of quality);
- the equitable remedy of specific performance (§6-400).

¶7-035 Implied terms. In every contract for the sale of goods (and, in some jurisdictions, services) there are certain terms which are implied into the contract by the *Trade Practices Act 1974* (Cth) or the State or Territory

38. ie action *in rem* or legal action against the thing itself: §3-020.

Sale of Goods Acts.³⁹ These terms impose obligations which are “statutorily created and take effect by a legal fiction, namely that the parties made a contract including the relevant obligations.”⁴⁰

The *Trade Practices Act* applies if the transaction involves:

- a “corporation” (or other person regulated by the Commonwealth: ¶7-220) as supplier; and
- a “consumer” as buyer (¶7-012).

If the *Trade Practices Act* does not apply, the transaction may be regulated by the relevant *Sale of Goods Act*. The sale of goods legislation is based on the English *Sale of Goods Act* of 1893 which codified the common law as it then stood.⁴¹

The *Trade Practices Act* and equivalent laws in all States and Territories provide consumer protection because they cannot be excluded from consumer contracts (¶7-170—¶7-205). The Sale of Goods Acts can be excluded from non-consumer contracts.⁴²

Whether the parties have mentioned the matter or not, the implied terms (mostly conditions) are placed into every sale of goods contract whether asked for or not. This means that a breach of one of these implied terms can be treated as a breach of contract, for which one remedy is damages for breach of contract.⁴³ The implied terms number five:

1. That the seller has the right to sell the goods (¶7-040—¶7-050).
2. That the goods will correspond with their description (¶7-060).
3. That the goods will be of merchantable quality (¶7-070—¶7-080).

39. *Goods Act 1958* (Vic) sec 17-20; *Sale of Goods Act 1923* (NSW) sec 17-20; 1896 (Qld) sec 16-18; 1895 (SA) sec 12-15; 1895 (WA) sec 12-15; 1896 (Tas) sec 17-20; 1954 (ACT) sec 17-20; 1972 (NT) sec 17-20; *Consumer Transactions Act 1972* (SA) sec 6; *Trade Practices Act 1974* (Cth) Pt V Div 2 sec 69-72, Div 2A sec 74B-74E. Section 66A of the *Trade Practices Act* provides that the provisions of the United Nations Convention on Contracts for the International Sale of Goods (the Vienna Sales Convention) prevails over the implied conditions Division to the extent of any inconsistency as from 1 April 1989.

40. *Austral Pacific Group Ltd v Airservices Australia* [2000] HCA 39 at [9].

41. The State and Territory sale of goods legislation is substantially uniform in

wording, but section numbers vary. If section numbers are mentioned here, they are those in the Vic, NSW, Tas, ACT and NT legislation; corresponding provisions in the other jurisdictions are given in footnotes.

42. Implied conditions cannot be excluded from consumer contracts because of the following legislation: *Goods Act 1958* (Vic) sec 95, 108; *Sale of Goods Act 1923* (NSW) sec 62-64; *Consumer Transactions Act 1972* (SA) sec 10(1); *Fair Trading Act 1987* (WA) sec 34, 35; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 68, 69, 81; *Trade Practices Act 1974* (Cth) sec 68, 68A, 74K.

43. Not damages under *Trade Practices Act* sec 82: ¶8-840.

4. That where the buyer makes known the purpose for which the goods are required, the goods will be reasonably fit for that purpose (§7-090).
5. That, if it is a contract for sale by sample, the bulk will correspond with the sample (§7-100).

If these conditions are not fulfilled, the purchaser may sue for breach of contract (§6-320) in addition to any remedy available under the *Trade Practices Act* (§8-750).

§7-040 Seller's right to sell the goods. Section 69 of the *Trade Practices Act* and the equivalent sections in State and Territory laws⁴⁴ imply undertakings regarding title, quiet possession (§7-045) and freedom from encumbrances (§7-050) into the sale of goods contract.

It is an implied condition that the seller, in a case of sale, has the right to sell the goods, or, where an agreement to sell is involved, will have the right to sell the goods at the time when property will pass. This provision would be relied on by an innocent purchaser where, for example:

- a used car is sold and later repossessed by the seller's hire-purchase company because of hire-purchase arrears;
- a stolen car is sold, then repossessed.

In each of these examples the purchaser has an action against the seller by virtue of the implied condition.

— *Case example* —

A buyer of a car had some months' use of it before he learned that the seller had no title and that it had to be returned to the true owner. He sued to recover the price and it was held that he was entitled to recover the whole purchase price and that the seller was not entitled to set-off anything for the use of the car.

It was held that the fact that the buyer had had some use of the car made no difference, on the basis that the buyer had accepted the car on the representation that the seller had the right to deal with the goods which he did not have. The buyer had received something different from that for which he had contracted. He had not received the goods, nor had he received the right to possession of the goods, and in those circumstances there had been a complete failure of consideration.

— *Rowland v Divall*⁴⁵ —

44. Vic, NSW, Tas, ACT, NT sec 17; Qld sec 15; SA, WA, sec 12; Consumer sales: TPA sec 69; Vic sec 86; NSW no equivalent — title in consumer sales is covered by sec 17; SA *Consumer*

Transactions Act 1972 sec 6(1)); WA *Fair Trading Act* 1987 sec 36; NT *Consumer Affairs and Fair Trading Act* 1990 sec 62.

45. [1923] 2 KB 500; [1923] All ER Rep 270.

This case has often been criticised⁴⁶ as having been incorrectly or unintelligently decided because there had never been a claim from the true owner of the car against the buyer.

The expression "right to sell" will probably be given the same meaning as it was given in the following case:

— *Case example* —

An American firm sold a quantity of tins of "Nissly brand" condensed milk to an English buyer. These were detained by the English Commissioners of Customs on the basis that they infringed the Nestlé (pronounced "Nessly") trade mark. The buyers could not get possession of the tins without removing all the labels, and they could be sued by Nestlé if they attempted to sell the labelled tins. They removed the labels, and resold the tins at a loss. It was held that the American firm had no "right to sell" the goods because of the infringement of the registered trade mark.

— *Niblett Ltd v Confectioners' Materials Co Ltd*⁴⁷ —

Limiting the scope of the implied conditions or warranties on title. The opening words of sec 17 of the *Sale of Goods Act 1923* (NSW) (and equivalents), which deals with implied undertakings as to title, clearly state that the section can be excluded: "In a contract of sale, unless the circumstances of the contract are such as to show a different intention ...". These words are applicable only to non-consumer sales of goods; the equivalent sections in the consumer sales law of Victoria, South Australia and the *Trade Practices Act* do not provide for exclusion.

It has been suggested that an attempt to exclude the operation of sec 17 would produce a conflict with another provision⁴⁸ of the Act with its definition of a contract of sale, which by definition involves a transfer of property or ownership in the goods for a money consideration.⁴⁹ The conflict would be between the seller promising on the one hand to sell the goods and on the other insisting that ownership in the goods is not being passed and the seller is therefore not making a sale. After all, the transfer of property is the essence of a sale, and a transfer of possession only cannot make up a sale. Case law supports the proposition that sec 17 can be excluded where, for instance, the seller will not guarantee that property will pass or where the seller transfers property without the right to sell.⁵⁰

46. See, eg Law Reform Committee (UK), Twelfth Report, 1966 Cmnd 2958, para 36; Treitel, *Some problems of breach of contract* (1967) 30 MLR 139 at pp 146-149; see now *Goods Act 1958* (Vic) sec 101(1).

47. [1921] 3 KB 387; [1921] All ER Rep 459.

48. Vic, NSW, Tas, ACT, NT sec 6; Qld sec 4; SA, WA sec 1.

49. Sutton, KCT, *Sales and Consumer Law*, LBC Information Services, 4th ed, 1995, p 338; Hudson, AH, *The condition as to title in the sale of goods* (1957) 20 MLR 236; Hudson, AH, *The exclusion of section 12(1) of the Sale of Goods Act* (1961) 24 MLR 690.

50. eg *Niblett Ltd v Confectioners' Materials Co Ltd* [1921] 3 KB 387 at p 401.

Similarly, a limited title to the goods could be transferred under sec 69 of the *Trade Practices Act*. Although sec 69 makes clear that title and quiet possession are to be passed to the consumer, there is also provision for the seller to transfer “only such title as he or a third person [eg a wholesaler] may have” where the circumstances of the contract so indicate.

It seems that, in contrast to the position with sec 17 of the *Sale of Goods Act* (NSW), sec 69 of the TPA cannot be excluded. (To intend to do so may constitute an offence under sec 53(g) and equivalents: ¶7-370.)

¶7-045 Warranty of quiet possession. The second subsection involving title in *Trade Practices Act* sec 69(1) and Sale of Goods Acts equivalents implies a warranty that the buyer shall have and enjoy quiet possession of the goods. “Quiet” here means “undisturbed”.

This subsection is wider than the first subsection. Under the first subsection, the seller assures the buyer that the seller has the interest being transferred; under the second subsection, there is an assurance by the seller against the consequences of a defective title and therefore an assurance against any disturbance so caused.⁵¹ A further difference between the subsections lies in the different commencement times regarding the limitation of actions. In the former, it is the date of the sale; in the latter, it is the date of the disturbance.

¶7-050 Freedom from encumbrances. The third subsection in *Trade Practices Act* sec 69(1) and Sale of Goods Acts equivalents (see ¶7-040 for comparative section numbers) states that there is an implied warranty that the goods shall be free from any charge or encumbrance in avour of any third party, not disclosed or known to the buyer before or at the time when the contract is made.

This subsection presents another aspect of the general implied undertaking as to title.

— *Case example* —

C bought a car from B and resold it to D. Unknown to all parties, sales tax was owing on the car from a previous owner A, and, under the relevant State legislation, a car with tax owing could be seized by the government.

51. A disturbance to the buyer's possession could be actionable in tort. See *Healing (Sales) Pty Ltd v Inglis Electrix Pty Ltd* (1968) 121 CLR 584; (1968) 42 ALJR 280. Apple Computers restrained Wombat Computers from infringing Apple's copyright over its programs, etc. It was alleged that, because Wombat was not, by reason of the copyright infringement, the owner of the silicon chips in their computers, it would not be able to satisfy the condition as to title

and the warranty as to quiet possession implied into every sale of its computers by sec 69 of the *Trade Practices Act* 1974 (Cth): *Apple Computer Inc v Computer Edge Pty Ltd* (1984) 1 FCR 549; (1984) ATPR ¶40-453. Ultimately the High Court decided in Wombat's favour, finding no remedy in copyright against Wombat: *Computer Edge Pty Ltd v Apple Computer Inc* (1986) 161 CLR 171; (1986) 60 ALJR 313; ¶3-505.

This was held to amount to a "charge or encumbrance" within the subsection, which entitled D to recover from C, who could recover from B, who could recover from A!

— *Steinke v Edwards*⁵² —

¶7-060 Seller's duty to sell goods that correspond with description. Under *Trade Practices Act* sec 70 and State/Territory equivalents,⁵³ there is an implied condition in every contract for the supply of goods by description that the goods correspond with the description. If a sale is by sample as well as description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

What is a sale by description? The words clearly apply to cases where the purchaser has not seen the goods and relies on a description contained in a newspaper advertisement, catalogue or the like, or where the buyer is relying on a description of goods not yet in existence, eg wheat not yet harvested. It applies to cases where the buyer has actually seen the goods where the goods have been described on a label or package or where the description is contained in the contract.

— *Case examples* —

Make and model of car. D advertised a car for sale as a "Herald convertible, white, 1961". P purchased it, believing like D that it was a 1961 model. P later discovered that the car was made up of two cars welded together, the rear being from a 1961 model and the front from an earlier model. P was entitled to damages for breach of the implied condition on description, assessed as the purchase price less the value of the car as scrap.

— *Beale v Taylor*⁵⁴ —

P bought a five-year-old van from D's car yard in reliance on the words "low kilometres" written across the windscreen and its low odometer reading of 42,224 km on a five figure odometer. When P discovered that the van's real odometer reading was much higher, P was entitled to rescind for D's breach of the implied condition that goods must comply with their description.

— *Reynolds v Turner*⁵⁵ —

52. Local Court of Adelaide, unreported, noted (1935) 8 ALJ 368.

53. Vic, NSW, Tas, ACT, NT sec 18; Qld sec 16; SA, WA sec 13; Consumer sales: TPA sec 70(1), 74C; Vic sec 87; NSW no direct equivalent although sec 64 prevents sec 18 from being excluded from consumer sales; SA *Consumer Transactions Act* 1972 sec 6(3); WA *Fair Trading*

Act 1987 sec 37; NT *Consumer Affairs and Fair Trading Act* 1990 sec 63, 74.

54. [1967] 1 WLR 1193; [1967] 3 All ER 253.

55. (1989) ASC ¶55-922. The odometer showed 42,224 km. However, evidence was given that suggested the car had travelled 142,224 km. It was possible that the odometer had been replaced or that it had been deliberately "wound back".

This means that a sale in a self-service shop could be a “sale by description” under this section even though a person is buying something displayed on the counter. An item is sold by description so long as it is sold as corresponding to a description such as “woollen undergarments”.⁵⁶ Case law shows that descriptions can cover “walking shoes”,⁵⁷ canned fruit packed 30 tins to a case⁵⁸ and a second hand reaping machine stated to have been new the previous year and hardly used at all.⁵⁹

This section is concerned with description rather than quality.

— *Case example* —

Mink food. P, a mink breeder, contracted with D, a company which compounded animal food, to mix and deliver mink food according to P’s formula. One of the ingredients was herring meal, which D bought from D2, a Norwegian firm. Unknown to any of the parties, the herring meal had become contaminated by the use of a preservative and as a result was highly toxic and dangerous to mink. When many mink died, P sued D, and D sought indemnity from D2:

- (1) D was not in breach of the implied condition on description, as the mink food complied with its description. The section was concerned with identity or description, not with quality or fitness. The food, even though contaminated, was still mink food as described.
- (2) D was in breach of the implied condition of merchantable quality under sec 19(2) and equivalents: ¶7-070.
- (3) D was in breach of the implied condition of fitness for purpose under sec 19(1) and equivalents, because P had relied on D’s skill or judgment to select quality ingredients as set out in P’s formula: ¶7-090.

————— *Ashington Piggeries Ltd v Christopher Hill Ltd*⁶⁰ —

Limiting the scope of the implied condition on description. Section 70 of the *Trade Practices Act* and equivalents is short, and sounds absolute in stating that goods must correspond with their description “where there is a contract for the supply ... of goods ... by description ...”. To avoid liability under this section, all the seller has to do is to make clear that the sale is not a sale by description, but is a sale of specific goods. True, a sale where the buyer has seen the goods may be a sale by description if a name tag or label is relied upon. But case law shows the seller has real room to manoeuvre on the definition of sale by description. It has clearly been said by the courts

56. *Grant v Australian Knitting Mills Ltd* [1936] AC 85 at p 100; (1935) 54 CLR 49 at p 61; ¶7-090.

57. *David Jones Ltd v Willis* (1934) 52 CLR 110.

58. *In re Moore & Co Ltd and Landauer & Co* [1921] 2 KB 519; [1921] All ER Rep 466.

59. *Varley v Whipp* [1900] 1 QB 513.

60. [1972] AC 441; [1971] 2 WLR 1051; [1971] 1 All ER 847, noted (1973) 47 ALJ 742.

that it must be determined whether a description has been applied to the goods and whether they have been sold by that description:

“A difficulty, therefore, cannot but arise in determining when the sale is ‘by’ the description and when not. Apparently the distinction is between sales of things sought or chosen by the buyer because of their description and of things of which the physical identity is all important.”⁶¹

¶7-070 Seller’s duty to supply goods which are merchantable. Merchantability of goods is implied in two sections of the *Trade Practices Act* and State/Territory equivalents:

- sec 71(1): where goods are bought by description from a supplier in the course of a business, there is an implied condition that the goods are of merchantable quality, provided that if the buyer has examined the goods there is no implied condition as regards defects which that examination ought to have revealed.¹
- sec 72(c): in the case of a contract for supply by sample there is an implied condition that the goods will be free from any defect rendering them unmerchantable which would not be apparent on reasonable examination of the sample.²

For the first section to apply, there are three main requirements:

(1) *The goods are bought by description.* This means that the sale must be a sale by description, discussed in ¶7-060 above.

(2) *From a seller “in the course of a business”.* This test in the *Trade Practices Act* could apply to a seller dealing in goods for the first time. In contrast, the test in the *Sale of Goods Acts* is that the seller “deals in goods of that description (whether he be the manufacturer or not)”. The test in the *Sale of Goods Acts* has had the effect of narrowing the application of the condition because it must be shown that the seller does in fact deal in goods of the contract description. For the condition to apply, it is not enough to show that the seller is about to deal in such goods.³ It will, however, be enough to show that the seller deals in goods of the same kind as those in the contract description even if not having previously dealt in goods of that particular description. For example in the *Crago case*,⁴ the court rejected an argument that the condition could not apply

61. *Australian Knitting Mills Ltd v Grant* (1933) 50 CLR 387, per Dixon J at p 417; ¶7-090.

1. Vic, Tas, NT sec 19(b), 20(2)(c); NSW sec 19(2), 20(2)(c); ACT sec 19(4), 20(2)(c); Qld sec 17(2), 18(2)(c); WA sec 14(II), 15(2)(c); Consumer sales: TPA sec 71(1), 74D; Vic sec 88(1)(e), 89; NSW sec 64(1)-(3); SA *Consumer Transactions Act* 1972 sec 6(4); WA *Fair Trading Act* 1987 sec 38(1); NT *Consumer Affairs and Fair Trading Act* 1990 sec 64(1), 75.

2. Vic, Tas, NT sec 20(2)(c); NSW sec 20(2)(c); Qld sec 18(2)(c); WA sec 15(2)(c); Consumer sales: TPA sec 72(c), sec 74E; Vic sec 88, 89; NSW sec 64(1); SA *Consumer Transactions Act* 1972 sec 8(3), 8(4)(b); WA *Fair Trading Act* 1987 sec 39(c); NT *Consumer Sales and Fair Trading Act* 1990 sec 65(c).

3. As in *JS Robertson (Aust) Pty Ltd v Martin* (1956) 94 CLR 30.

4. *Crago v Multiquip Pty Ltd* (1998) ATPR ¶41-620; ¶7-212.

because the seller did not deal in ostrich incubators but in poultry incubators: as long as the seller dealt in goods of that kind, namely equipment for use in the poultry industry, it did not matter that it did not specifically deal in goods of the contract description, namely ostrich incubators.

(3) *The condition does not apply if the goods have been examined.* The implied condition of merchantability is excluded by this proviso in the first section and it is also excluded by the phrase “on reasonable examination of the sample” in the next. Examination of the goods will exclude the implied condition. It need not be a full and complete examination. For example, a quick glance at barrels of vegetable glue from the outside, without opening them and checking the contents, has been held to make up sufficient examination.⁵ The defects in the engine of a second hand car were apparent to the buyer on inspection, especially as the engine was largely dismantled at the time.⁶ But if the defect cannot be revealed by the examination, the condition will not be excluded.⁷

In the case of a sale by sample, the goods must be free from any defect rendering them unmerchantable which would not be apparent on reasonable examination. For example, if defects in fabric cannot be discovered on reasonable examination, the condition will still apply.⁸ What is a reasonable examination is the real question, the answer to which will depend on the circumstances. In purchasing a catapult, for instance, pulling back the elastic would amount to a reasonable examination. It is not necessary to do any more by way of examination, eg biting it, hitting it, applying a match to it.⁹

Limiting the scope of the implied condition on merchantable quality. The scope of *Trade Practices Act* sec 71(1) and equivalents on merchantable quality can be “failed” — the seller can argue that the implied condition (see also ¶7-080) does not apply for one of the following reasons:

- (1) If the buyer has examined the goods, the implied condition does not apply under the sec 71(1)(a) or (b) provisos or Sale of Goods Acts equivalents. Clearly, all the seller has to do is to ensure that the buyer has examined the goods and this will have the effect of removing reliance from the seller on to the buyer.
- (2) Reliance on the exceptions in sec 71(1) and equivalents shows that the implied condition does not apply to “defects specifically drawn to the consumer’s attention before the contract is made”. All it will take on the part of the seller is notice to the buyer that X, Y and Z defects exist.

Some goods will be more merchantable than others. Reasonableness is the test, and it depends on price and description. Clearly, “as is” goods, “as

5. *Thornett & Fehr v Beers & Son* [1919] 1 KB 486.

6. *Jones v West Star Motors Pty Ltd* (1995) ATPR ¶41-447 (Court of Appeal, Qld) (buyer unsuccessful under TPA sec 71(1) and also under sec 52: ¶7-280).

7. *Frank v Grosvenor Motor Auctions Pty Ltd* [1960] VR 607 at p 609.

8. *Drummond v Van Ingen* (1887) 12 App Cas 284.

9. *Godley v Perry* [1960] 1 All ER 36.

traded” factory seconds and “second hand” items refer to descriptions which will water down legal requirements of merchantability.

¶7-080 Merchantable quality. If the buyer satisfies the requirements set out in ¶7-070, the buyer will have a claim against the seller if the goods are not of “merchantable quality”. This means that if “there is a defect such that a reasonable buyer would take it into account and reject the goods, they are unmerchantable; if not, they are merchantable.”¹⁰

More formally stated, the “expression ‘merchantable quality’, in relation to goods the subject of a contract of sale, must, obviously, constitute a reference to their condition or quality. Consequently, goods are said to be of merchantable quality ‘if they are of such a quality and in such a condition that a reasonable man, acting reasonably, would, after a full examination, accept them under the circumstances of the case in performance of his offer to buy them, whether he buys them for his own use or to sell again’.”¹¹

The period of merchantability depends on the nature of the goods and the “degree” of merchantability purchased. First class goods must be more merchantable than factory seconds. A hot water bottle must not burst after five days’ use.¹²

In the words of Professor Sutton, “to establish that goods are unmerchantable the buyer has to prove that ... goods of the same general character and description are not commercially saleable.”¹³

— *Examples: merchantable quality* —

- dead sugar cane mixed with bulk sugar cane made the cane unmerchantable;¹⁴
- timber, bought for piano manufacture, which was affected by dry rot and only suitable for making boxes was unmerchantable;¹⁵
- defective “walking shoes” were unmerchantable;¹⁶
- Dr Grant’s contaminated underpants were unmerchantable;¹⁷ and
- that software is “Y2K compliant”.¹⁸

10. *Anthony v Esanda Ltd* (1981) 55 ALJR 17, per Murphy J at p 21.

11. eg *George Wills & Co Ltd v Davids Pty Ltd* (1957) 98 CLR 77 at p 89.

12. *Preist v Last* [1903] 2 KB 148. Kapnoullas, S and Clarke, B, *Countdown to zero: the duration of statutory rights for unfit and unmerchantable goods* (1999) 14 JCL 154.

13. Sutton, KCT, *Sales and Consumer Law*, LBC Information Services, 4th ed, 1995, p 286.

14. *Kirwan v Farleigh Estates Sugar Co Ltd* [1918] St R Qd 133.

15. *H Beecham & Co Pty Ltd v Francis Howard & Co Pty Ltd* [1921] VLR 428.

16. *David Jones Ltd v Willis* (1934) 52 CLR 110; ¶7-060.

17. *Grant v Australian Knitting Mills* (1935) 54 CLR 49; [1936] AC 85; ¶7-090.

18. eg Hughes, G, *Y2K warranties and disclaimers* (1999) 73(7) LIJ 36, assuming that computer software is “goods”: ¶7-015.

This common law test is the test of the merchant and, because it relates to the saleability of the goods, it is more appropriate to commercial sales. In contrast, the modern statutory definition of merchantable quality set out in, for example, the *Trade Practices Act 1974* (Cth) sec 66(2) and 74D(1) and (3) focuses on the reasonable objective expectations of a “consumer” (¶7-012) and to that extent common law definitions of merchantable quality may not be relevant in statutory interpretation:¹⁹

Section 66(2) [“Merchantable quality”]

“Goods of any kind are of merchantable quality within the meaning of this Division if they are as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect having regard to any description applied to them, the price (if relevant) and all the other relevant circumstances.”

If goods are not fit for one of their purposes, they will not come up to standard of statutory merchantability.

— Case example —

Mr and Mrs P ordered tufted cut-pile 100% pure wool high quality carpet from carpet retailer D (the local representative of the New Zealand manufacturer) for their home for some \$13,000. About six weeks after the carpet was laid, marks like water marks started appearing on the carpet.²⁰ P rescinded the contract under the *Trade Practices Act 1974* (Cth) sec 75A (¶8-765), and was awarded damages of some \$12,900 plus interest for the following breaches of the implied conditions:

- The carpet was not of merchantable quality (sec 74D). Because the definition in sec 74D(3) (and sec 66(2)) refers to “purpose or purposes”, the carpet, while achieving one purpose (covering the floors), failed in its other purpose (appearance, blending into the existing decor, etc) and was therefore not merchantable because it did not fit its dual purposes.
- The carpet was not reasonably fit for P’s purpose (sec 74B). In issue were two of the fitness for purpose tests set out at ¶7-090: the “particular purpose” of test (1), and the reliance on the seller’s skill and judgment of test (2). These were clearly fulfilled because D knew P’s purpose for the carpet. D’s non-disclosure of the possibility of shading did not make P’s reliance unreasonable, and indeed compounded the problem of P’s reliance.
- The carpet did not comply with the sample (sec 74E: ¶7-100). As the carpet supplied did not accord with the sample when the shading appeared, sec 74E was breached.

— *Rasell v Garden City Vinyl and Carpet Centre Pty Ltd*²¹ —

19. See also TPA sec 74D(3); *Sale of Goods Act 1923* (NSW) sec 64(3); *Consumer Transactions Act 1972* (SA) sec 6(5); *Fair Trading Act 1987* (WA) sec 33(2); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 61(2), 75(3).

20. This “water marking” or “pile reversal” was explained as a natural phenomenon with that type of carpet which could not

be cured. There was evidence that the phenomenon was well known in the industry though not proved to be caused by any particular flaw in the manufacturing technique.

21. (1991) ATPR ¶41-152 (Supreme Court of Queensland, Full Court); (alternative citation) *Rasell v Cavalier Marketing (Australia) Pty Ltd* [1991] 2 Qd R 323.

¶7-090 Seller's duty to supply goods which are fit for their purpose.

Where a buyer expressly or by implication makes known to a seller the particular purpose for which the goods are required, there is an implied condition that the goods will be reasonably fit for that purpose under *Trade Practices Act* sec 71(2) and State/Territory equivalents.²² The buyer must, however, show reliance on the seller's skill and judgment and the goods must be of a description which it is in the normal course of the seller's business to supply. No condition of fitness for purpose is implied where the contract is one for a specified article under its patent or other trade name. For the implied condition to apply, all the tests in the section must be fulfilled:

Test (1) Has the buyer made known to the seller the particular purpose for which the goods are required? The particular purpose need not be specified where the goods which are required have really only one purpose. If a person buys a hot water bottle,²³ an automatic irrigation and fertiliser system for tomatoes with specified fertiliser,²⁴ or carpet,²⁵ the very description of the goods is enough to indicate their purpose and so fulfil the first test.

— Case example —

Dr Richard Grant (P), an Adelaide doctor aged 38, was confined to bed for 17 weeks as a result of contracting serious dermatitis after wearing two new woollen singlets and two new pairs of long johns which contained traces of chemical left over from the processing of the wool.

P sued the retailer for breach of fitness for purpose and merchantability (¶7-070) under the *Sale of Goods Act*, and sued the manufacturer for negligence. The trial judge awarded damages of £2,450.

This judgment was set aside by the High Court. P failed under the *Sale of Goods Act*, and also failed to prove negligence. The High Court found that the process of manufacture was "prudent and reasonable" and the amount of chemical negligible, as proved by the general absence of claims from other users (for the 4.7 million items manufactured in the same way during the previous six years).²⁶

On appeal, the Privy Council restored the decision of the trial judge in P's favour:

P v Retailer. (1) The implied condition of fitness for purpose applied because of P's reliance on the retailer's choice of a quality product suitable to be worn next to the skin without being washed first. (2) The implied condition

22. Vic, Tas, NT sec 19(a); NSW sec 19(1); ACT sec 19(2); Qld sec 17(1); WA sec 14(I); SA sec 14(I); Consumer sales: TPA sec 71(2), 74B; Vic sec 90; NSW sec 64(1), (3), (4); SA *Consumer Transactions Act* 1972 sec 6(6); WA *Fair Trading Act* 1987 sec 38(2); NT *Consumer Affairs and Fair Trading Act* 1990 sec 64(2), 73.

23. *Preist v Last* [1903] 2 KB 148.

24. *Schepis v Elders IXL Ltd* (1987) ATPR ¶40-759; (1986) 70 ALR 729.

25. *Rasell v Garden City Vinyl and Carpet Centre Pty Ltd* (1991) ATPR ¶41-152, set out at ¶7-080.

26. (1933) 50 CLR 387.

of merchantability was also breached because the goods were unfit to be worn next to the skin (§7-080).

P v Manufacturer. The manufacturer was held liable for negligence (§4-060ff) due to the presence of the chemicals — a latent defect in the process of manufacture which could not be detected by inspection (like the decomposed snail in the opaque bottle (§1-350—§1-360)). No distinction could be made between drink (taken internally) and clothing (used externally). The defence that the manufacturer lost “control” of the underwear in the sense that it was distributed loose compared to the manufacturer’s continued “control” of the sealed drink was rejected: in both cases, the product was intended to reach the consumer as it had left the manufacturer.

*Grant v Australian Knitting Mills*²⁷

If the goods are required for a special purpose the position is different because that special purpose must be made clear to the seller before the condition can apply.

Case example

A consumer with abnormally sensitive skin contracted dermatitis from an overcoat. At the time of purchase, the consumer had not disclosed her sensitivity to the seller, and legal action against the seller failed on the basis that no particular purpose had been made clear. In other words, the failure of a customer to make proper disclosure of relevant peculiarities may mean that test (1) is not satisfied.

*Griffiths v Peter Conway Ltd*²⁸

Test (2) *Has the buyer relied (and shown the seller that reliance) on the seller’s skill or judgment?* To satisfy this test the buyer must actually rely on the seller’s skill and judgment, and the buyer’s reliance on that skill and judgment must be disclosed to the seller. The test operates even if a buyer has researched the product, so long as “the buyer makes known to the seller the particular purpose for which goods are required *so as to show* that the buyer relies on the seller’s skill and judgment.”²⁹ The buyer must rely on the *seller’s* skill and judgment. Thus, reliance on a government certificate³⁰ or on an agent or expert of some kind will not be sufficient to establish the first requirement of this test.³¹

Disclosure by the buyer of reliance on the seller must be made either expressly or by implication at or before the time of contracting. Whether there has been such a disclosure is a question of fact to be determined from the surrounding circumstances.³² For example, where the seller is a manufacturer, the inference that the buyer is relying on the seller’s skill and judgment may be easily made by the seller. The inference may not be made so easily where the buyer discloses no more to the seller than the particular

27. (1935) 54 CLR 49; [1936] AC 85.

28. [1939] 1 All ER 685.

29. *Crago v Multiquip Pty Ltd* (1998) ATPR §41-620 at p 40,806; §7-212.

30. *Phoenix Distributors Ltd v LB Clarke (London) Ltd* [1967] 1 Lloyd’s Rep 518.

31. *Dependable Motors Pty Ltd v Ashford Shire Council* (1960) 101 CLR 265.

32. *Ibid*, per *McTiernan J* at p 277.

purpose for which he is purchasing the goods.³³ Whether the seller should have known from the disclosure that the seller's skill and judgment were being relied on will depend on the circumstances surrounding the transaction.

— *Case example* —

"*The Roxy*". D contracted to pay P \$69,000 for the supply and laying of plain grey carpet in D's nightclub to cater for young "upmarket" patrons. The carpet was rated heavy-duty domestic. After about a year, the carpet was unsightly because of cigarette burns, stains, chewing gum ground in and heavy wear and tear, and D refused to pay the balance owing of \$20,000. When sued by P, D's defence was that the carpet was not fit for its purpose under the *Sale of Goods Act*. The court held that although P knew D's purpose, there was no sufficiently clear disclosure of purpose by D to show reliance on P's skill so as to imply a condition of fitness for purpose. After all, D knew more about nightclub wear and tear than P did. Installation of heavy-duty commercial carpet would have made no difference, as the problems with the carpet were caused by the patrons, not the carpet.

— *Carpet Call Pty Ltd v Chan*³⁴ —

Test (3) *Are the goods supplied in the course of a business?*

Test (4) *The trade name proviso.* The *Sale of Goods Acts* (but not the *Trade Practices Act*) provide that the fitness for purpose condition will not be implied where the buyer orders goods under their trade name in such a way as to show that the buyer does not rely on the seller's skill and judgment.³⁵ The test is: does the buyer specify the article under its trade name in a way that indicates satisfaction (right or wrong) that it will answer the buyer's purpose (even though this purpose is disclosed to the seller) and that the buyer is not relying on the skill and judgment of the seller, however great that may be?³⁶

Limiting the scope of the implied conditions on fitness for purpose. Attacks which might be made on the application of the implied condition of fitness for purpose might include the following:

- (1) The buyer has not made known to the seller the particular purpose for which the goods are required, notwithstanding the fact that some goods are clearly being purchased for one possible reason only: the hot water bottle, the clothes-peg. A clause in the contract to the effect that the buyer does not rely upon the seller's skill or judgment may not be effective unless the seller can show that the buyer had notice of it and had consented to it.
- (2) The buyer has not relied on the seller's skill or judgment. All the seller has to do is to say "I don't know" or "I really can't say" and sec 71(2) (TPA) and *Sale of Goods Acts* equivalents may not come into operation. Where the seller is a specialist in hardware, for example, and then seeks to

33. *Claude B Fox Pty Ltd v Rayner* [1978] Qd R 250.

34. (1987) ATPR (Digest) ¶46-025 (Supreme Court, Qld).

35. *Baldry v Marshall* [1925] 1 KB 260; [1924] All ER Rep 155.

36. *Ibid* at KB p 266; cf *Wilson v Rickett Cockerell & Co Ltd* [1954] 1 QB 598.

escape the implied condition by this method, the courts may not be convinced. It has been held that “mere disclosure of a purpose may amount to sufficient evidence of reliance”.³⁷

(3) The goods are of a description which are not normally supplied in the course of the seller’s business. A private seller can apparently never be caught by sec 71(2) and equivalents because the goods must be supplied in the course of a business.

(4) The trade name proviso in the Sale of Goods Acts (not the TPA) can also work to the seller’s benefit. By establishing reliance on the fact that the item is Brand X, and that the buyer wants Brand X and nothing else, the seller will show that there was no reliance. In the same way, if the buyer relies on another person, the buyer will fail to establish reliance on the seller, unless the buyer can show at least partial reliance on the seller.

¶7-095 Seller’s duty in relation to the supply of services. The *Trade Practices Act* and equivalent legislation in some jurisdictions implies obligations into consumer transactions for the supply of services. Echoing the language of the implied conditions in contracts for the sale of goods, sec 74(1) of the *Trade Practices Act 1974* (Cth)³⁸ provides that a warranty that services will be rendered with due care and skill will be implied into all contracts for supply by a corporation in the course of a business to a consumer. A further warranty of fitness for purpose applies to any materials supplied in connection with these services (sec 74(1)). Section 74(2) further provides that, unless the circumstances show that the consumer does not rely on, or that it is unreasonable to rely on, the corporation’s skill or judgment, there is an implied warranty that the services provided and any materials supplied “will be reasonably fit for that purpose”.

These warranties of due care and skill (sec 74(1)) and fitness for purpose (sec 74(2)) apply to “services” as defined widely in sec 4 (¶7-290). This definition includes professional services including those of an agent (¶11-160), (except those provided by architects or engineers so far as the application of sec 74(2) is concerned)³⁹ and excludes those in sec 74(3)

37. *Manchester Liners Ltd v Rea Ltd* [1922] 2 AC 74 at p 81; [1922] All ER Rep 605 at p 608.

38. Corresponding with, eg, *Australian Securities and Investments Commission Act 1989* (Cth) sec 12ED; *Goods Act 1958* (Vic) sec 91 (Terms implied in sale of services) and sec 92 (Fitness of services for purpose); *Consumer Transactions Act*

1972 (SA) sec 7; *Fair Trading Act 1987* (WA) sec 40; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 66.

39. An exemption judged “not justified” and the repeal of which was recommended in Trade Practices Commission, *Study of the professions — architects*, November 1992.

(transportation or storage of goods for a business customer⁴⁰ and insurance: ¶7-310).⁴¹

— *Case examples* —

P's employer contracted with carrier D for the removal of household effects in Queensland from Ayr to Dalby. The goods were damaged in transit, and P was entitled to sue for compensation for breach of the implied warranties under sec 74. They cannot be excluded under sec 68: ¶7-170. Because the limitation of liability under former State law (to \$200)⁴² was directly inconsistent with the Commonwealth *Trade Practices Act* sec 74, the State law was held invalid under sec 109 of the Constitution (¶1-475).

————— *Wallis v Downard-Pickford (North Queensland) Pty Ltd*⁴³ —

When P's aircraft landed at Sydney airport, the pilot parked it on the tarmac at the Qantas Executive Jet Area in readiness for servicing by Qantas which was to cost about \$5,000. While P's aircraft was parked there, Qantas negligently backed another aircraft into it. P, a "consumer" under sec 4B (¶7-012), sued Qantas for the damage under sec 74 for failure to exercise "due care and skill". Qantas admitted liability, but it was successful in claiming indemnity from P under the indemnity clause in the contract. The High Court held that this was not inconsistent with Qantas' non-excludable obligation under sec 74 or any of the matters referred to in sec 68(1)(a)-68(1)(c)(¶7-170).

————— *Qantas Airways Ltd v Aravco Ltd*⁴⁴ —

In addition, at common law there is an implied term in a contract for work that the contractor will use reasonable care and skill and do the work in a "workman-like" manner.⁴⁵

¶7-100 Seller's duty to supply goods which correspond with sample. The *Trade Practices Act* and State/Territory equivalents imply three conditions into a contract for the supply of goods by reference to a sample (see ¶7-110). Such contracts include those for the supply of carpet, wheat and wool by reference to a sample. The mere fact that a sample was

40. *Comalco Aluminium Ltd v Mogal Freight Services Pty Ltd* (1993) ATPR (Digest) ¶46-106 (transport contract outside TPA).

41. See further Kyrou, EJ, *Section 74 looms over solicitors and accountants* (1987) 61 LIJ 46; Gould, LR, *Implied terms in contracts between professionals and their clients: the doctor-patient exemplar* (1992) 22 UWAL Rev 139. "Services" for the purposes of sec 74 includes banking: *Warnock v Australia and New Zealand Banking Group Ltd.* (1989) 5 ANZ Insurance Cases ¶60-897; (1989) ATPR ¶40-928, (¶17-500), and travel: *Baltic Shipping Company "The Mikhail*

Lermontov" v Dillon (1993) 67 ALJR 228, discussed at ¶6-220.

42. Under the now repealed *Carriage of Goods by Land (Carriers' Liabilities) Act 1967* (Qld) and equivalents in most jurisdictions, such as the *Common Carriers Act 1902* (NSW).

43. (1994) 179 CLR 388; (1994) ATPR ¶41-300.

44. (1996) 70 ALJR 590, (1996) ATPR ¶41-486. Kirby J dissented.

45. *Zorba Structural Steel Company Pty Ltd v Watco Pty Ltd* (1993) 115 FLR 206 (¶6-110).

shown is not enough to convert a sale into a sale or supply by sample unless the parties so agreed.

The effects of a sale by sample were set out in the following classic exposition:

“The sample speaks for itself. But it cannot be treated as saying more than such a sample would tell a merchant of the class to which the buyer belongs, using due care and diligence, and appealing to it in the ordinary way and with the knowledge possessed by merchants of that class at the time.”⁴⁶

Any defects that cannot be disclosed by the sample are not excluded by inspection of the sample. And examination of the sample can only go so far. It cannot be expected that a buyer will be able to pull the sample to pieces to find out its inner realities. Because this duty is not imposed, the sample can only be taken to reveal what is obvious after reasonable examination. The seller remains liable for any defects not reasonably able to be detected by the buyer (§7-110).

§7-110 Conditions implied into a sale by sample. The legislation⁴⁷ implies three conditions into a sale by sample, the breach of any one of which allows the buyer to reject the goods and terminate the contract unless the buyer has accepted the goods.

(a) *The bulk must correspond with the sample in quality.* The requirement of an ordinary examination to determine the true nature of the sample was made clear in *Hookway's case*.⁴⁸ True, a defect in the sample could be discovered by laboratory examination, but because it was required that a defect be apparent on an ordinary examination, the implied condition still held. The implied condition that the bulk will correspond with the sample is not breached if differences between the two are of a minor nature and the quality of the goods is unaffected by the difference. The test for correspondence in quality was stated by Lord Diplock in *Ashington Piggeries Ltd v Christopher Hill Ltd*⁴⁹ to be:

“... restricted to characteristics of the goods which a reasonable examination of the sample ought to have revealed, that is, characteristics which would be apparent upon physical inspection of the sample and the goods and the application to them of such other tests as are customarily applied in the trade.”

46. Per Lord MacNaghten in *Drummond v Van Ingen* (1887) 12 App Cas 284 at p 297.

47. Vic, NSW, Tas, ACT sec 20(2); Qld sec 18(2); SA, WA sec 15(2); NT sec 20(2). Consumer sales: TPA sec 72, 74E; Vic sec 88; NSW no direct equivalent although sec 64 prevents sec 20 from being excluded

from consumer sales; SA *Consumer Transactions Act* 1972 sec 6 (3) and (4); WA *Fair Trading Act* 1987 sec 39; NT *Consumer Affairs and Fair Trading Act* 1990 sec 65, 76.

48. *FE Hookway & Co Ltd v Alfred Isaacs & Son* [1954] 1 Lloyd's Rep 491.

49. [1972] AC 441 at p 514; §7-060.

The character of some goods necessitates minor variations in quality; in such cases, substantial correspondence as to quality is required. If the goods do not correspond with the sample, the liability for breach of the condition rests with the seller. This is so even when the discrepancy could be easily rectified.⁵⁰

(b) *The buyer shall have a reasonable opportunity of comparing the bulk with the sample.* This means that the buyer will not be deemed to have accepted the goods until the buyer has had a chance to compare the bulk with the sample. The Sale of Goods Acts give a general right of inspection,⁵¹ and this provision is a special instance of this right in that the buyer may inspect before the goods are tendered. There is a presumption that the goods will be inspected by the buyer at the place from which they will be dispatched but this may be altered by agreement between the buyer and seller. If the goods are to be sent from a long distance, the buyer may have the right to inspect at the buyer's place of business.⁵² The inspection must be carried out within a reasonable time. A buyer will not be deemed to have accepted the goods until the buyer has had a chance to examine them. Once the goods have been accepted, the buyer loses the right to reject them and terminate the contract for breach of condition, but may still sue for damages for breach of warranty that the bulk does not correspond with the sample. Examination is therefore an important factor in determining the rights between the parties.

(c) *The goods shall be free of any defects rendering them unmerchantable.* In addition to compliance with sample, the goods must also be of merchantable quality unless the defect could have been discovered by reasonable examination of the sample, whether or not there has been any actual examination. The definition of merchantable quality under statute is more consumer oriented than the case law definition (§7-080), and because the *Trade Practices Act 1974* (Cth) sec 74E does not contain a definition of "unmerchantable" as does sec 66(2) or sec 74D(3), its meaning for the purposes of sec 74E must be the case law meaning.⁵³

Limiting the scope of the implied condition on sale by sample. A strict technical reading of sec 72 of the *Trade Practices Act* and Sale of Goods Acts equivalents shows how the seller can escape this implied condition. Although the section appears absolute, it does provide the seller with room to manoeuvre.

The mere fact that a sample was shown is not enough to turn a sale into a "sale by sample". There must be an express or implied term in the contract that the goods are supplied by reference to the sample, and if the contract is put into writing with no reference to the sample, the parol evidence rule will prevent the incorporation of a "sale by sample" term and the sale will not be a sale by sample.

50. *E & S Ruben Ltd v Faire Bros & Co Ltd* [1949] 1 KB 254.

51. Vic sec 41; NSW sec 37; Qld sec 36; Tas sec 39; ACT sec 38; NT sec 37; SA, WA sec 34.

52. *Canterbury Seed Co Ltd v JG Ward Farmers' Association Ltd* (1894) 13 NZLR 96.

53. *Rasell v Garden City Vinyl and Carpet Centre Pty Ltd* (1991) ATPR ¶41-152 (¶7-080).

¶7-120 Exclusion of seller's liability. The sale of goods legislation permits exclusion of the implied conditions on fitness, merchantability, etc, in contracts not involving consumers:

"Where any right duty or liability would arise under a contract of sale by implication of law it may be negated or varied by express agreement or by the course of dealing between the parties or by usage if the usage be such as to bind both parties to the contract."⁵⁴

Contracts often contain words to the effect that all or some conditions and warranties are excluded. The wording may take the following forms:

"All conditions and warranties to the extent allowed by law are excluded."

"Our exclusive customer warranty is your protection and guarantee of satisfaction."

"This guarantee is in lieu of all other warranties, express or implied and of all other obligations or liabilities on our part."

"The guarantor accepts no responsibility for any consequential damage or loss in transit, or for any repairs attempted to be made without his sanction."

"Customer to pay 50% parts and labour."

The approach of the courts at common law to exclusion clauses has been considered in the context of contract law (¶6-180ff). That law applies whether the exclusion appears in a contract for the sale of goods or a contract of any other kind. However, as noted, the courts view exclusion clauses in consumer contracts with disfavour and have tended to declare them void where they work unfairly to the benefit of one party.

It is difficult to know exactly how far an exclusion clause can operate. If the contract is for a "new Singer car", no exclusion clause could help the seller if what was delivered was not new, not a car or not a Singer.⁵⁵ But even if sellers' obligations under the Sale of Goods Acts can be excluded in theory, the seller still has to show that the exclusion clause was actually part of the contract,⁵⁶ or that the buyer had been given reasonable notice of it, or that the exclusion could actually exclude the default in question.

However, exclusion of implied terms is prohibited or restricted under the legislation discussed in ¶7-170—¶7-205 below.

¶7-170 Countering exclusion clauses in consumer contracts: *Trade Practices Act 1974* and *Fair Trading Acts*. Section 52 of the *Trade Practices Act* and State/Territory *Fair Trading Act* equivalents provide remedies for misleading or deceptive conduct, for example where the

54. Vic sec 61; NSW sec 57; Tas sec 59; ACT sec 58; Qld sec 56; WA, SA sec 54 (*Consumer Transactions Act* sec 8).

55. *Andrews Brothers (Bournemouth) Ltd v Singer & Co Ltd* [1934] 1 KB 17; [1933] All ER Rep 479.

56. And not just a receipt, eg, see *Causser v Browne* [1952] VLR 1; ¶6-200.

effect of an exclusion clause has been suppressed or not disclosed (§7-250ff and especially §7-281).

In addition, the *Trade Practices Act 1974* (Cth) sec 68 and the parallel ASIC, Western Australian and Northern Territory provisions¹ provide that exclusions of the Sale of Goods Act provisions of the TPA,² sec 69-72,³ are void (§5-827). This section (subject to the exceptions in sec 68A,⁴) renders void any attempt to exclude or limit the operation of the contractual terms implied by sec 69-74.⁵

An example of a provision rendered void by sec 68⁶ would be "all conditions express or implied are hereby negated" (see also §7-120). If the rider "to the extent permissible by law" were added, the legal effectiveness would be no different, because the "extent permissible by law" is no extent. No exclusion is possible.

The *Fair Trading Act* (which especially targets "no refund" policies in the FTA equivalent of TPA sec 53(g): §7-370) cannot itself be excluded in South Australia,⁷ Queensland⁸ and Tasmania.⁹

Non-personal goods. Section 68A (and sec 74L) of the *Trade Practices Act 1974* (Cth) and sec 12EC of the *Australian Securities and Investments Commission Act 1989* (Cth) ("the ASIC Act") allow a supplier in the case of a non-personal, domestic or household use contract (such as the supply of a commercial computer or a truck) to limit liability for breach of condition or warranty to the following:

- "(i) the replacement of the goods or the supply of equivalent goods;
- (ii) the repair of the goods;
- (iii) the payment of the cost of replacing the goods or of acquiring equivalent goods;
or
- (iv) the payment of the cost of having the goods repaired."

In the case of services, such as the painting of a building or the repair of a computer, the permissible exclusion is limited by sec 68A(1)(b) to:

- "(i) the supplying of the services again; or

1. *Australian Securities and Investments Commission Act 1989* (Cth) sec 12EB; *Fair Trading Act 1987* (WA) sec 34; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 68.

2. See other legislation where contracting out is not possible: leases §3-760; car sales §7-600—§7-610; Small Claims Tribunals §7-720.

3. *Fair Trading Act 1987* (WA) sec 36-39; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 62-65.

4. *Fair Trading Act 1987* (WA) sec 35; *Consumer Affairs and Fair Trading Act*

1990 (NT) sec 69. See also TPA sec 74K (NT sec 81) preventing the exclusion of Pt V Div 2A (Actions against Manufacturers and Importers of Goods).

5. *Fair Trading Act 1987* (WA) sec 36-40; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 62-66.

6. *Fair Trading Act 1987* (WA) sec 34; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 68.

7. *Fair Trading Act 1987* (SA) sec 96.

8. *Fair Trading Act 1989* (Qld) sec 107.

9. *Fair Trading Act 1990* (Tas) sec 51.

- (ii) the payment of the cost of having the services supplied again.”

What sec 68A does is to enable a supplier to limit its liability for consequential loss such as economic loss caused by a machinery breakdown.

Section 68A provides a list of matters to be looked at by the court in determining if it is fair or reasonable for a supplier to rely on the exclusions in sec 68A(1).¹⁰ If it is unfair or unreasonable for the limitation to apply, it can be struck out. Section 68A(3) states that what is fair and reasonable shall include the following points, but that a court is not limited to these alone:

- “(a) the strength of the bargaining positions of the corporation and the person to whom the goods or services were supplied ...;
- (b) whether the buyer received an inducement to agree to the term or, in agreeing to the term, had an opportunity of acquiring the goods or services ... from any source of supply under a contract that did not include that term;
- (c) whether the buyer knew or ought reasonably to have known of the existence and extent of the term ...; and
- (d) in the case of the supply of goods, whether the goods were manufactured, processed or adapted to the special order of the buyer.”

¶7-180 Countering exclusion clauses: misrepresentation legislation. Misrepresentation legislation in two jurisdictions restricts the right to exclude liability for pre-contractual misrepresentation (¶5-705). Section 8 of the *Misrepresentation Act 1972* (SA) and sec 6 of the *Law Reform (Misrepresentation) Act 1977* (ACT) provide that any clause in a contract which purports to exclude or restrict any liability to which a party may be subject by reason of any misrepresentation, or which purports to exclude or restrict any remedy available to another by reason of such misrepresentation, is of no effect, except to the extent to which the court may allow reliance on it as being fair and reasonable in the circumstances of the case. Thus any attempt to exclude liability for any misrepresentation can be overridden.

¶7-190 Countering exclusion clauses: *Consumer Transactions Act 1972* (SA). South Australia was the first Australian jurisdiction to provide for non-excludable conditions and warranties in the case of specially defined consumer transactions. Section 2 of the *Consumer Transactions Act 1972* (SA) defines a “consumer” as a person (“other than a body corporate”) entering a “consumer contract”, defined as a contract or agreement for the purchase or hire or acquisition of the use or benefit of goods or services for less than \$40,000.

If there is such a consumer transaction, sec 8 provides that the conditions and warranties implied into consumer contracts by the Act “may not be

10. See also, eg, *Goods Act 1958* (Vic) sec 97(5).

excluded, limited or modified by agreement". Moreover, any purported exclusion, limitation or modification of a condition or warranty should be regarded as ineffectual unless it is proved that the consumer's attention was drawn to it before the formation of the contract. Words to similar effect are to be found in sec 6 of the *Manufacturers Warranties Act 1974* (SA):

"... it shall not be competent for a manufacturer to exclude or limit his liability, or for a consumer to waive his rights, arising by virtue of an express or statutory warranty."

As discussed at ¶7-220, the equivalent federal law takes precedence in this area if the transaction is one of the kind regulated by the *Trade Practices Act 1974* (Cth).

¶7-200 Countering exclusion clauses: NSW *Sale of Goods Act*. Part VIII consisting of sec 62-64 was added to the *Sale of Goods Act 1923* (NSW) in 1974. A consumer sale is defined in sec 62 as:

"... a sale of goods (other than a sale by auction) by a seller in the course of a business where the goods:

- (a) are of a kind commonly bought for private use or consumption; and
- (b) are sold to a person who does not buy or hold himself out as buying them in the course of a business."

Section 64(1) provides that:

"Any provision in, or applying to, a contract for a consumer sale and purporting to exclude or restrict the operation of all or any of the provisions of sections 18, 19 and 20 (section 19(4) excepted) or any liability of the seller for a breach of a condition or warranty implied by any provision of those sections is void."

¶7-205 Countering exclusion clauses: Victorian *Goods Act*. The *Goods (Sales and Leases) Act 1981* (Vic) added Part IV, consisting of sec 84-119, to the *Goods Act 1958* (Vic). Section 95, like other anti-exclusion clause provisions noted above, provides that a term of a sale which purports to exclude, restrict or modify the application of Part IV is void. As Part IV applies to consumer sales only, it is only exclusions from consumer sales which are affected by sec 95; exclusion clauses relating to ordinary sales under the *Goods Act* continue to be effective.

MANUFACTURERS' LIABILITY/PRODUCT LIABILITY

Development of manufacturers' liability or product

liability law ¶7-206

Manufacturers' liability in the tort of negligence ¶7-208

Manufacturers' liability under contract law ¶7-210

¶7-200

Manufacturers' liability under <i>Trade Practices Act</i> Part V Div 2A	¶7-212
Manufacturers' liability under other sections of the <i>Trade Practices Act</i>	¶7-213
Manufacturers' liability: State and Territory legislation	¶7-214
Manufacturers' liability for defective goods: <i>Trade Practices Act</i> Part VA	¶7-215

¶7-206 Development of manufacturers' liability or product liability law. A little over 100 years ago there were no clearly established legal principles holding manufacturers legally liable to the ultimate consumer for the quality and safety of their products. With the development of the industrial revolution, the advent of mass-produced consumer goods and their widespread distribution and large scale advertising, the reaction of the legal system has been gradually to hold manufacturers legally liable to consumers for the quality and the safety of their products. If a person is injured by a manufactured product, there are a number of legal options under the Australian manufacturers' liability laws:

- (1) liability under the tort of negligence, established in *Donoghue v Stevenson* (¶4-060ff, ¶7-208);
- (2) liability for damages for breach of contract with the retailer, or possibly the manufacturer if there is a contract with the manufacturer (¶7-210);
- (3) liability of the retailer for breach of contractual warranties implied by the *Trade Practices Act* (where it applies: ¶7-012) and/or the *Sale of Goods Act* (¶7-035ff). If there is a contract between buyer and manufacturer, the buyer can also sue the manufacturer under this law;
- (4) statutory liability of the manufacturer (if there is no privity of contract) under Part V Div 2A of the *Trade Practices Act* and other statutes in some jurisdictions (¶7-060ff; ¶7-212);
- (5) statutory liability for defective goods under Part VA of the *Trade Practices Act* (¶7-215);
- (6) liability for breach of a product information standard and/or a product safety standard under the *Trade Practices Act* (¶7-495);
- (7) liability for misleading or deceptive conduct under the *Trade Practices Act* (¶7-250).

The circumstances may indicate the best choice or choices, and it is true to say that there is no coherent Australian product liability law which determines when compensation is payable for injuries, death or other losses caused by defective products. One solution would be for the *Trade Practices Act* Part

VA — point (5) above — to be adopted as Australia's sole product liability law to provide a simple, efficient law for the benefit of consumers.¹¹

Accidents and injuries (including those caused by negligent misstatement: ¶4-295) are now increasingly being contested under consumer legislation contained in the *Trade Practices Act 1974* (Cth) (and the parallel *Sale of Goods Act* and *Fair Trading Act* of each jurisdiction) as well as in tort.

The following cases illustrate the parallel remedies, and some of their strengths and weaknesses.

— Case examples —

Medically acquired AIDS cases have appeared before the courts where transfusion victims have claimed damages — in negligence and consumer laws — from blood transfusion authorities, doctors and hospitals.

Of 42 applications involving blood transfusions in the period 1983-1985 to be filed in November 1989, the judge agreed to hear P's case as a test case. (The judge regretted that the Australian Law Reform Commission's class actions or grouped proceedings recommendations had not yet become law (¶7-770), and that each claim on common questions of fact or law could not be determined at a single hearing to avoid repetition of evidence in each of the later cases.) The 42 applicants were reduced to 41 with the death of an infant, infected by breast feeding, whose mother had received the virus in a post-childbirth transfusion.

P, a married heterosexual man aged about 60, had acquired AIDS from a blood transfusion he received during a coronary angiography operation in 1984. He claimed compensation, under the laws outlined below, from D1 (the Australian Red Cross Society), D2 (the New South Wales Division of that Society) and D3 (the successor to the management of The Royal Prince Alfred Hospital, where the transfusion was conducted):

Negligence. None of the defendants disputed that they each owed a duty of care to P in connection with the transfused blood plasma but they could show that they were not liable as they had conformed with the standard of care owing in 1984.

The donor information form, which allowed blood donations by high risk male homosexual donors to get through (and which was later superseded by a detailed questionnaire), did not in the context of knowledge available in 1984 amount to actionable negligence.

Failure to make an earlier decision regarding surrogate hepatitis testing and the delay in implementing the surrogate testing decision at that time would only amount to negligence if prudent persons in the position of the defendants would have determined that the concern for contamination outweighed the difficulties resulting in reducing the blood supply.

Negligent misrepresentation. Applying *Smith v Hughes* (¶5-700), and accepting that a representation need not be expressly made but can be

11. eg Travers, RC, *A proposal to reform Australian product liability law* (1995) 69 ALJ 1006.

implied, there was no representation concerning the safety or effectiveness of the blood transfusion or the blood. Indeed, there was no contact between P and D1 or D2, and the only contact between P and D3 concerning the transfusion related to matters of detail — there was no representation as to the characteristics of the blood, before or at the time of the transfusion.

Trade Practices Act 1974 (Cth)

Misleading or deceptive conduct (sec 52: ¶7-250) and misleading conduct in relation to services (sec 55A: ¶7-415). P's claim that D's conduct was liable to mislead the public as to the nature or suitability of the plasma for its purpose was not determined by the judge because the claim failed on the constitutional ground of the absence of "trade or commerce":

- D1 and D2 do not engage in "trade or commerce" (¶7-220), since they supply blood gratuitously.
- Although D3 did engage in "trade or commerce" because of its hospital fees, P's claim was outside the three-year claim period of sec 82(2) and was therefore statute barred (¶8-840).
- In any case, D1 and D2 were held to be "trading corporations" within sec 51(xx) of the Constitution through their blood transfusion services and the sale of goods (¶7-220, ¶9-370). The Royal Prince Alfred Hospital (D3) was not exempt under sec 2A of the TPA as being under such a degree of government control as to qualify as an "emanation of the Crown" (¶8-020), and it was also confirmed to be a "trading corporation".

Implied terms (sec 71 and 74). These sections read implied conditions of quality or fitness into contracts with a consumer for the sale of goods (sec 71: ¶7-070—¶7-090) and implied warranties into contracts for the supply of services (sec 74: ¶7-095) (P was held to qualify as a "consumer" under sec 4B, and its predecessor as it stood in 1984: ¶7-012):

- Section 71 could not operate, because there was not a contract for the supply of blood plasma with each D (the only contract — with D3 — was for nursing services).¹² Section 19 of the *Sale of Goods Act 1923* (NSW) (¶7-070—¶7-090) also could not operate. (This Act was no doubt alternatively relied on in case the TPA was held not to apply for the constitutional reasons of "trade or commerce" or "corporation": ¶7-220.)
- Similarly, sec 74 could not operate against D1 and D2 in the absence of a contract. There was a contract with D3 for nursing services, and D3's arguments that these were not supplied "in the course of a business", and that blood plasma is not "materials" (under sec 74(2)) were rejected. However, P failed under sec 74 as the blood transfusion did not qualify as "services" as defined in 1984. (The current wide definition of services in sec 74(3) substituted in 1986 would now include nursing services provided under contract by D3: ¶7-095.)

Although P's case was unsuccessful in his claim for damages under all the laws raised, the judge commented that P and others in the same

12. This point was upheld on appeal: (1991) 31 FCR 299; (1992) ATPR ¶41-156.

position "have a strong moral claim" upon the community for some financial assistance in coping with their illnesses. During the hearing, counsel for D3 (the hospital) offered free hospital and medical care for P.

"E" v *Australian Red Cross Society*¹³ —

A 79-year-old woman, who had bought a cup of coffee from McDonald's, spilled it in her lap and suffered third-degree burns which required skin grafts. McDonald's had a policy of serving coffee as hot as car radiator fluid (82°C-87°C) and, despite another 700 burns claims, took no action to serve it cooler. The jury awarded her US\$2.86m (A\$3.85m), made up of US\$200,000 (reduced to US\$160,000 due to her 20% contribution: ¶4-160) and US\$2.7m punitive damages (exemplary damages: ¶4-200) equal to two days of the company's profits from coffee. The damages were reduced to US\$48,000 by the judge and the case was settled for a confidential amount.

*McDonald's case*¹⁴ —

¶7-208 Manufacturers' liability in the tort of negligence.

The *Donoghue v Stevenson* neighbour/proximity principle set out at ¶1-360 (particularly the quotation from p 599 of the law report) confirms the liability of a manufacturer in negligence to the ultimate consumer, especially where goods sold are intended to reach the consumer with no reasonable possibility of intermediate examination. This general principle, considered further at ¶1-350, ¶1-380 and ¶4-080ff, is not limited to manufacturers of a whole product, and applies equally to manufacturers of component parts, assemblers, distributors, importers and retailers. The manufacturer of the completed product is not yet responsible vicariously or otherwise under this area of law for the negligence of manufacturers of component parts or anyone else in the process of production, despite overseas authority and Law Reform Commission recommendations to the contrary.¹⁵

¶7-210 Manufacturers' liability under contract law.

Unless the consumer actually buys from the factory or the workshop, the consumer does not generally contract directly with the manufacturer, and the consumer's remedy in contract is only against the other party to the contract (usually the retailer). The doctrine of privity of contract (¶6-260—¶6-270) prevents legal action against the manufacturer of goods if there is no contract between the manufacturer and the ultimate consumer.

13. (1991) 27 FCR 310; (1991) ATPR ¶41-085. See further *H v The Royal Alexandra Hospital for Children* (1990) Aust Torts Reports ¶81-000. The remaining AIDS blood transfusion cases were settled in 1995. The 430 infected are reported to have received \$140m.

14. Discussed in "Liability law — a liability?", *The Australian*, 26 September 1995, p 11.

15. eg *Peake v Steriline Manufacturing Pty Ltd* (1988) Aust Torts Reports ¶80-154. In this case an injured employee failed to recover in negligence vicariously from his employer, or from the manufacturer of a machine, for injury caused by a defective part of the machine obtained from a third party sub-manufacturer.

There are at least three ways around the obstacle of privity of contract:

(1) The consumer can sue the retailer, and the retailer can in turn sue the distributor for indemnity, and the distributor will in turn sue the manufacturer for indemnity. Each link in this chain will depend upon the solvency of the party as well as the absence of an exclusion clause (§6-180ff). Statutory enactments relating to exclusion clauses in both consumer and non-consumer contracts apply in some jurisdictions (§7-170—§7-205).

(2) A manufacturer may be held liable if there is a collateral contract (§6-030). This means that an undertaking by the manufacturer direct to the consumer is the consideration for the consumer's entering a contract of purchase from the retailer. In the *Shanklin Pier case*,¹⁶ the assurance of the paint manufacturer was that the paint would last for at least seven years; on the strength of this, the consumer purchased the paint from the retailer and, when the paint gave way after three months, was able to recover from the manufacturer in contract for economic loss for breach of express warranty.

(3) Arguably, manufacturers' guarantees fall into a category similar to that of the collateral contract in (2) if the consumer can establish knowledge of the existence of the guarantee at or before the time of purchase, and that the guarantee/warranty was intended to have contractual effect.

§7-212 Manufacturers' liability under *Trade Practices Act* Part V Div 2A. Legislation going back many centuries imposed liability on manufacturers under pure food laws and weights and measures laws.

If there is a contract between manufacturer and consumer, the consumer can sue the manufacturer under that contract. The sale of goods legislation (originally passed in the nineteenth century) and the *Trade Practices Act 1974* (Cth) (§7-035—§7-110) imply contractual conditions and warranties into manufacturers' contracts, but these apply only where there is a contract between manufacturer and consumer.

Part V Div 2A of the *Trade Practices Act* (entitled "Actions against manufacturers and importers of goods") was added in 1978 to allow consumers to sue manufacturers for damages where there is *no* contract between them so long as the consumer has acquired from an intermediary (such as a seller or retailer) who has acquired them from the manufacturer for re-supply.¹⁷

Part V Div 2A provides that:

- manufacturers and importers are concurrently liable to the seller, the consumer and the end-user of the goods in relation to certain statutory obligations, and
- the seller of the goods can recover damages from the manufacturer

16. *Shanklin Pier Ltd v Detel Products Ltd* [1951] 2 KB 854; [1951] 2 All ER 471.

17. Div 2A provides a statutory exception to the doctrine of privity of contract (§6-270).

where a consumer could have recovered similar damages from the manufacturer (sec 74H).

This legislation provides an alternative to suing in negligence. Negligence requires proof of a breach of a duty of care (§4-150), and sometimes limits recovery for pure economic loss (§4-215).

Division 2A was preceded by manufacturers' liability legislation in NSW (1974), SA (1974) and the ACT (1977), noted at §7-214.

Operation of Part V Div 2A

Application of Part V Div 2A — “consumer”/manufacturer. There are several preconditions to manufacturers' liability under Div 2A:

- The plaintiff must be a “consumer” as defined in sec 4B (§7-012) or an end-user — a “person who acquires the goods from, or derives title to the goods” from the consumer.¹⁸ For example, in *Donoghue v Stevenson*, Mrs Donoghue and/or her friend who actually purchased the contaminated ginger beer would be able to sue under Div 2A (§1-350). Unlike Part VA, Div 2A does not give rights to innocent bystanders injured by defective goods (§7-215).
- The goods must be “goods of a kind ordinarily acquired for personal, domestic or household use or consumption” (sec 74A(2)(a)).¹⁹ This definition corresponds with the definition of “consumer” in sec 4B (§7-012). The following goods have been held to fall outside the sec 74A(2)(a) definition:
 - a “reduction photocopier”;²⁰
 - an airseeder for use on a farm;²¹
 - a large tractor;²²
 - a \$155,000 prime mover;²³ and
 - an ostrich egg incubator and hatcher.²⁴

For the purposes of the *Trade Practices Act*, goods include goods which would normally be classified as fixtures such as air conditioning units (§3-090).

- The manufacturer must have supplied the goods in the course of trade

18. *Trade Practices Act* sec 74B(1)(e); 74C(1)(d); 74D(1)(d); 74E(1)(e); 74F(c)(ii); 74G(1)(d).

19. Div 2A applies to consumer goods “unless the contrary appears”. The contrary intention is shown in sec 74H (where the manufacturer supplies a seller) and sec 74L (the supply of non consumer goods).

20. *Four Square Stores (Qld) Ltd v ABE Copiers Pty Ltd* (1981) ATPR ¶40-232.

21. *Jillawarra Grazing Co v John Shearer Ltd* (1984) ATPR ¶40-441.

22. *Atkinson v Hasting Deering (Queensland) Pty Ltd* (1985) 6 FCR 331; (1985) ATPR ¶40-566.

23. *Minchillo v Ford Motor Company of Australia* (1994) ATPR (Digest) ¶46-119.

24. *Crago v Multiquip Pty Ltd* (1998) ATPR ¶41-620.

or commerce to an intermediary (such as a seller), who has acquired them for re-supply.

Manufacturers of component parts are not intended to be liable under Div 2A unless their components are "goods" within Div 2A, for example a manufacturer of replacement parts such as mower blades or brake pads. A "brandnamer" found liable under Div 2A could sue the manufacturer of a defective component part in contract, sale of goods or tort.

According to Div 2A, a "manufacturer" includes:

- primary producers and food manufacturers, since the term "manufactured" is defined to include "grown, extracted, produced, processed and assembled" (sec 74A(1));
- "brandnamers" applying their own name to the goods (sec 74A(3), (5), (6));
- assemblers or deemed manufacturers, who have assembled goods from component parts (sec 74A(3), (5), (6));
- importers (sec 74A(3), (7)).

Liability of manufacturer. There are two threshold tests before Div 2A can apply:

- the Constitutional requirements that the manufacturer is a "corporation" or equivalent, and that it is acting in "trade or commerce" (¶7-220); *and*
- the goods are supplied via an intermediary (seller) to a "consumer" (as defined in sec 4B: ¶7-012).

Statutory obligations. Division 2A makes a manufacturer liable for breach of the following, paralleling the statutory obligations in the buyer/seller sale of goods contract:²⁵

- *Fit for purpose.* The goods must be reasonably fit for their purpose: sec 74B. The manufacturer is liable if the consumer made known to the intermediary (the seller) its "particular purpose" in buying the goods and that it relied on the intermediary. This parallels liability under TPA Div 2 and the sale of goods legislation (¶7-090). The Act provides the following defences: the breach was caused by an act or default of another person or a "cause independent of human control", or the consumer did not rely on the manufacturer (sec 74B(2)).
- *Description.* The goods must correspond with their description: sec 74C. This parallels liability under TPA Div 2/sale of goods legislation

25. These are not conditions in the contractual sense with the right to repudiation, as there is no contract between manufacturer and consumer. Section 75A confirms the right to rescind only for breach of an

implied condition in Div 2. Because of the use of the word "warranty" in contract law (¶6-050), the description "statutory warranties" is avoided.

(¶7-060). The Act provides defences: the breach was caused by an act or default of another person or a “cause independent of human control”, or the description was applied without consent (sec 74C(2), (3)).

- *Merchantable quality.* The goods must be of merchantable quality: sec 74D. This parallels liability under TPA Div 2/Sale of Goods Acts (¶7-070). Examples of the meaning of “merchantable quality” are given at ¶7-080. The extent of liability for merchantable quality is affected by the price of, or any description applied to, the goods by the manufacturer.

— *Case example* —

Mr and Mrs P bought an egg incubator and hatcher in 1991, manufactured by D, for use in their ostrich breeding business from a retailer of equipment for use in the poultry industry. They claimed that due to deficiencies in the machines, they lost 90 fertile eggs worth some \$2m.²⁶ Their claim under sec 74B and 74D failed as they could not establish that the machinery was “goods” for the purposes of sec 74A(2)(a), as discussed above, namely goods for “personal, domestic or household use or consumption”. There was no evidence that the machinery was deficient and other breeders used it successfully. Hence their claims under the *Sale of Goods Act* (¶7-070), sec 52 (¶7-280) and sec 53(a) (¶7-300) of the *Trade Practices Act* and under common law negligence (¶4-060ff; ¶7-208) were unsuccessful.

*Crago v Multiquip Pty Ltd*²⁷ —

The Act provides the following defences:

- the breach was caused by an act or default of another person, or by a “cause independent of human control” after the goods had left the manufacturer, or
- the defects were drawn to the attention of the consumer before the contract was made, or,
- if the consumer had examined the goods before the contract was made, liability is limited to the defects the examination ought to have revealed (sec 74D(2)).

The manufacturer’s liability under the sec 74D test of “merchantable quality” should be compared with liability for negligence and Part VA. The manufacturer’s liability for negligence requires the existence of a duty of care, breach of that duty and injury, including injury to a third party (¶4-060ff), while its liability under Part VA is based upon an injury caused by a defective product (¶7-215).

26. In the early 1990s, a pair of adult birds was worth about \$70,000. The market for ostriches collapsed in 1995.

27. (1998) ATPR ¶41-620; see also *Ryan v Great Lakes Council* (1999) ATPR

(Digest) ¶46-191 (consumer contracted hepatitis A from contaminated oysters; judgment of \$30,000 for breach of sec 75B and sec 75D).

- *Sample.* The goods must comply with the sample: sec 74E. This parallels liability under TPA Div 1/Sale of Goods Acts (§7-100).

The Act provides the following defences: the manufacturer did not supply the sample; the sample was supplied without authority; the failure to comply occurred after the goods left the manufacturer or was due to circumstances beyond the control of the manufacturer (sec 74E(2)).

Example

The manufacturer of goods is liable to compensate a consumer for loss or damage. The manufacturer is not liable under Div 2A if breaches occur after the goods have left the manufacturer as a result of an act or default of a person other than the manufacturer or through a cause independent of human control.

*Explanatory Memorandum*²⁸

- *Repair facilities.* Section 74F requires a manufacturer to provide repair facilities or spare parts, and it will be liable for unreasonable failure to ensure that such facilities are available to the consumer. However, the manufacturer can effectively contract out of this requirement if it makes it clear at the outset that none will be available.
- *Warranties.* The manufacturer may be liable for warranties contained in packaging — sec 74G provides that the manufacturer is liable for any “express warranty”, defined in sec 74A(1) to mean “an undertaking, assertion or representation” in relation to matters such as quality; services that may be required; the supply of spare parts and the future availability of identical goods.

Compensation. Division 2A provides that if there is a breach of the manufacturer’s obligations “the corporation is liable to compensate the consumer ... for the loss or damage”.²⁹ This is similar to action for breach of a statutory duty in tort, and the measure of damages is the measure of damages in tort (§4-180).

Indemnity. If a seller is found liable to a consumer under contract for breach of an implied condition in the *Trade Practices Act*, the manufacturer is liable to indemnify the seller.

Right of seller to recover against manufacturer or importer. If the manufacturer and the seller are each found liable to a consumer for the same loss or damage under TPA Div 2A and Div 2 respectively, the seller can recover from the manufacturer an amount sufficient to provide indemnity in respect of the seller’s liability to the consumer (sec 74H).

Limitation period. An action under Div 2A must be commenced within three years (sec 74J).

28. House of Representatives, *Trade Practices Amendment Bill 1978*, *Explanatory Memorandum*, para 20.

29. *Trade Practices Act* sec 74B(1), 74C(1)(d), 74D(1), 74E(1), 74F(1)(c), 74G(1).

Application of Div 2A not to be excluded or modified. Section 74K renders void any exclusion, restriction or modification by contract of the application of Div 2A (¶7-170), and any term inconsistent with Div 2A will be void.

Limitation on manufacturer's liability to seller. Section 74L provides that if the goods are not "personal, domestic or household" goods, the liability of the manufacturer to the seller can be limited to the cost of replacing or repairing or supplying equivalent goods (whichever is the lowest amount) if this is "fair or reasonable" (¶7-170). What is "fair or reasonable" depends on the circumstances and, in particular, it depends on the availability of suitable alternative sources of supply of the goods, the availability of equivalent goods and whether the goods were prepared for a special order of the seller (sec 74L(3)). For example, under sec 74L the manufacturer may be able to replace a defective plug on an industrial machine.

¶7-213 Manufacturers' liability under other sections of the *Trade Practices Act*. In addition to liability under Part V Div 2 (¶7-035) and Part VA (¶7-215), other sections of the *Trade Practices Act 1974* (Cth) may also render a manufacturer liable to a consumer (whether or not there is a contract between them) for the following conduct:

- misleading or deceptive conduct (sec 52: ¶7-250ff). "If a manufacturer represents to the world at large that its product will perform a particular function, and that representation is false, misleading or deceptive there is no obvious reason to doubt that the conduct of the manufacturer, if it is a corporation and makes the representation in trade or commerce, infringes sec 52."³⁰
- false representations (sec 53: ¶7-290ff);
- other unfair practices such as offering gifts and prizes (sec 54: ¶7-400), misleading conduct (sec 55: ¶7-410; sec 55A: ¶7-415), bait advertising (sec 56: ¶7-420), referral selling (sec 57: ¶7-430), accepting payment without intending to supply as ordered (sec 58: ¶7-440);
- breach of product safety standards (sec 65C: ¶7-495) and product information standards (sec 65D: ¶7-495). In addition, there are numerous provisions in each of the States and Territories providing for the declaration of product standards and in particular for the declaration of standards in relation to the wholesomeness and purity of foods and drugs. However, unlike the *Trade Practices Act*, some of the State and Territory provisions do not provide any remedies to a consumer injured as a result of a breach of a product standard.

¶7-214 Manufacturers' liability: State and Territory legislation. Commonwealth laws on manufacturers' liability are paralleled by laws in some States and Territories. The Constitution provides that if a

30. *Crago v Multiquip Pty Ltd* (1998) ATPR ¶41-620, per *Lehane* J at p 40,799; ¶7-212.

State law is inconsistent with a Commonwealth law, the State law will be invalid to the extent of the inconsistency (sec 109: ¶1-475). State and Territory manufacturers' liability laws are as follows:

Manufacturers' liability in New South Wales. The *Sale of Goods Act 1923* (NSW) was amended in 1974 by the insertion of new sec 62-64. These sections provide that where a consumer has initiated proceedings arising out of a contract for the sale of new goods for breach of the warranty of merchantable quality, the court may add (join) the manufacturer as a party to the proceedings if it appears that the defect should be remedied by the manufacturer.

Manufacturers' liability in South Australia. The *Manufacturers Warranties Act 1974* (SA) imposes legal liability upon the manufacturer in favour of the consumer wherever the manufacturer has supplied defective goods. This Act creates a contractual relationship in the absence of privity of contract (¶6-260—¶6-270) between manufacturer and consumer and provides for a statutory warranty of merchantability, etc. The manufacturer's obligations travel with the goods, and are not limited to the first owner. Damages for breach of statutory warranty will therefore be assessed as if they were damages for breach of contract.

Manufacturers' liability in Queensland. Although not expressly providing for manufacturers' liability, the *Fair Trading Act 1989* (Qld) regulates express warranties communicated to a consumer (Part III Div 5 sec 73-79). In particular, the legislation provides that the issue of such a warranty, its communication to a consumer or its completion by the consumer does not negative any express or implied contractual warranty or condition affecting the goods or services to which the communicated warranty relates. This means that a provision in such a warranty which purported to exclude the manufacturer's liability for a breach of any other warranty or condition would be ineffective.

Manufacturers' liability in the Australian Capital Territory. The *Law Reform (Manufacturers Warranties) Act 1977* (ACT) provides that, where manufactured goods are sold or delivered to an ACT consumer, the manufacturer gives warranties as to the suitability and quality of goods. These warranties are similar in content to undertakings implied between seller and consumer by the sale of goods legislation and the *Trade Practices Act* (¶7-035). The fact that there is little manufacturing industry in the ACT does not curtail the operation of the Act; it applies to purchases of manufactured goods in the ACT wherever manufactured.

Manufacturers' liability in Victoria, Western Australia, Tasmania and the Northern Territory. In the absence of specific legislative enactment in Victoria, Western Australia, Tasmania and the Northern Territory, consumers must rely on remedies available in negligence (¶4-060ff), contract (including the sale of goods legislation) (Chapters 5 and 6) and under the *Trade Practices Act 1974* (Cth) (¶7-206). In addition, the *Fair Trading Act 1987* (WA) re-enacts the product safety standards and product information standards provisions of the TPA (¶7-495) as State legislation. The *Consumer Affairs and Fair*

Trading Act 1990 (NT) re-enacts legislation equivalent to TPA Part V Div 2A (above) as Territory legislation in Part V Div 3.

¶7-215 Manufacturers' liability for defective goods: *Trade Practices Act Part VA*. The law has responded to injuries caused by modern mass-produced products by the evolution of case law remedies in tort and in contract and bypassing the statute laws outlined above. The adequacy and appropriateness of federal laws relating to compensation for injury caused by defective or unsafe goods were referred in 1987 by the Commonwealth Attorney-General to the Australian Law Reform Commission for review and report.

The report of the ALRC (1989) proposed a "no defect" strict product liability, and proposed that a consumer should be entitled to compensation on proof of damage and causation without needing to prove that the goods were defective or the manufacturer negligent.³¹

In contrast to the ALRC, the European Directive provides that to establish a cause of action a consumer must prove that the product was defective and that the damage did not result from unreasonable use of the product.³²

Part VA of the *Trade Practices Act 1974* (Cth), based on the "European Directive", came into force in July 1992. A person who is injured or who suffers property damage as a result of a defective product has the right to compensation from the manufacturer without the need to prove negligence on the part of the manufacturer. The person responsible for putting defective goods into circulation is the person liable to compensate those who suffer loss because of the defect. In particular:

Defective goods

Goods have a defect if "their safety is not such as persons generally are entitled to expect": sec 75AC. This does not require goods to be absolutely free from risk. Because the test is the objective knowledge and expectations of the community (not the subjective knowledge and expectations of the injured party), the level of safety is that which the community is entitled to expect.

Potential defects include design defects (relating to matters such as the form, structure and composition of the goods), manufacturing defects (relating to the process of construction and assembly) and instruction defects (defects caused by incorrect or inadequate warnings or instructions).

31. See further ALRC, *Product Liability: Proposed Legislation*, Discussion Paper No 37, Canberra, AGPS, 1989.

32. Council Directive of July 25, 1985 on the Approximation of the Laws, Regulations

and Administrative Provisions of the Member States Concerning Liability for Defective Products (85/374/EEC); noted [1991] Reform 25.

Section 75AC(2) provides that in assessing the safety of goods, all the relevant circumstances are to be taken into account, including:

- the nature of the goods;
- community knowledge of the goods. For example, the benefit to the community as a whole of certain pharmaceuticals and vaccines outweighs their known negative side effects which cannot be avoided. The small statistical chance of injury from such goods does not of itself mean that they are “defective”;
- whether the goods are inherently dangerous, such as tobacco, guns and knives. Because these are by definition inherently dangerous and known to be such, community expectations in relation to them must include an understanding of the degree of risk involved with their use. In the case of goods where the nature of the danger is well known to the general community, the community expects (and must accept) a degree of risk. Other products where the risk is less generally known may require appropriate warnings;
- the price of the goods. The expectations of the product’s safety can be gauged by its retail price; for example, more expensive goods may have additional safety features not available with cheaper goods.

Section 75AC(2) lists a number of factors which must be considered in order to determine the safety of goods, including the following:

- *The manner and purpose of the marketing of the goods.* Section 75AC(2)(a) refers to “the manner in which, and the purposes for which, they have been marketed”. The level of warnings and instructions on goods marketed for young children should be appropriate for that age group. Those on goods marketed for professional or trade use could be expected to be less than for the ordinary consumer because the manufacturer could assume a certain amount of pre-existing knowledge on the part of the purchaser. (This does not mean that such goods require no warnings or instructions, but they will be different from those for the ordinary consumer). An untrained consumer cannot expect to receive detailed instructions when purchasing goods only meant for use by trained persons. Consumers are entitled to expect a high degree of safety from goods which are marketed in a manner depicting simplicity and safety.
- *Factors relating to presentation of goods.* Section 75AC(2)(b)-75AC(2)(d) refers to the following to help determine the safety of goods:
 - “(b) their packaging; and
 - (c) the use of any mark in relation to them; and
 - (d) any instructions for, or warnings with respect to, doing, or refraining from doing, anything with or in relation to them”.

Where the manufacturer knows that the goods are potentially hazardous, the manufacturer must provide:

- clear instructions and warnings to detail the nature and the extent of the potential hazard, and
- adequate instructions to help consumers to avoid that hazard.

Similarly, the general presentation of the goods can influence consumer expectations by exaggerating safety aspects or minimising reference to possible risks.

— *Case examples* —

“Big Boy Oven Cleaner” contains a warning label headed “SAFETY DIRECTIONS” ... Wear rubber gloves at all times.” A person who suffered second degree burns from the cleaner sued the manufacturer under sec 75AC alleging that the label did not adequately warn of the extremely corrosive action of the product on the skin or the steps to be taken if skin contact occurred.

— *Brooks v R & C Products Pty Ltd*³³ —

P tipped boiling water down a blocked shower pipe, and then tipped dry “Glendale Caustic Soda” down the pipe. Shortly after, P heard a whirring noise and was then hit in the face by a column of water which rushed out of the blocked pipe; P was burned in the face and eyes. P was successful under Part VA against D (the manufacturer), and D was liable to P for \$106,000 for damages, economic loss and expenses:

- D was deemed to be manufacturer of the goods as they had D’s label, even though the label stated that the goods were not manufactured by D but were “packed by” D (sec 74A(3), 75AB). Because D repackaged and labelled the bulk caustic soda, D was deemed to have “manufactured” it;
- D was liable under sec 75AD for defective goods manufactured by it;
- D’s goods had a defect within sec 75AC as their safety was not such as persons generally are entitled to expect. In determining the safety of the goods, regard could be had to the instructions or warnings on the label on the container which failed under sec 75AC(2) to state that:
 - the goods should not be used with hot water;
 - the goods should not be used when poured in a solid state directly into a drain (ie not mixed with water);
 - protective gear, goggles, etc should be worn, and
 - the goods could erupt.
- D could not rely on any defence under sec 75AK(1)(c), as information within state of “scientific or technical knowledge at the time” was available to D to indicate the defect.
- There was no evidence that P had contributed to his injuries under sec 75AN as a basis to reduce D’s liability under sec 75AD.
- D was also held liable for negligence at common law (¶4-070), and

33. (1996) ATPR ¶41-537, noted (1997) 5 TPLJ 133, which reports only the

preliminary issue of which court the case should be heard in.

there was no evidence of contributory negligence by P (¶4-160) to reduce D's liability to P at common law.

————— *Glendale Chemical Products Pty Ltd v ACCC*³⁴ ———

- *Expected use of the goods.* Section 75AC(2)(e) refers to “what might reasonably be expected to be done with or in relation to them”. This use includes all reasonably expected secondary uses and likely potential misuse. A manufacturer must warn consumers of the potential consequences of misuse which the manufacturer can anticipate, and the manufacturer may have to detail the specific consequences of such misuse. If the loss does result partially from misuse, the manufacturer will be able to reduce the amount of compensation payable to reflect the damage caused by the contributory acts of the injured person (sec 75AN; compare ¶4-160).
- *Time of supply of goods.* Section 75AC(f) refers to “the time when they were supplied by their manufacturer”. Goods which meet community expectations when they are supplied are not defective at a later time solely because the safety expectations of the community have increased. Similarly, goods which are older and have had more use cannot be expected to be as safe as brand new goods.

Part VA with its strict liability regime does not intend to retard product innovation and development, and sec 75AC(3) provides that goods are not defective solely because a safer product is later put on the market.

Goods do not have a defect if they comply with a Commonwealth mandatory standard (sec 75AC(4)) such as a product safety standard under sec 65C or a product information standard under sec 65D: ¶7-495. Section 75AC(4) recognises that there may be a time lag between scientific and technological advances and the development of new standards. For example, there can be a long period between the development of a drug and its release on to the market.

Meaning of manufacturer

“Manufacturer” is given the same extended definition in sec 75AA as is already used in the *Trade Practices Act 1974* in sec 74A: “‘manufactured’ includes grown, extracted, produced, processed and assembled”.

In addition, the definition of “manufacturer” which is extended in sec 74A(3) and (4) is incorporated into Part VA by sec 75AB. Under sec 74A(3), a corporation is deemed to be the manufacturer of the goods if it:

- holds itself out to the public as the manufacturer;
- “causes or permits” its name, business name (¶12-010), brand or mark (¶13-650) to be applied to the goods. “Applied” is defined as “woven in, impressed on, worked into or annexed or affixed to the goods”;

34. (1999) ATPR ¶41-672, noted ACCC Journal, Issue 18, p 29 (December 1998) (¶7-330) dismissing appeal from (1998)

ATPR ¶41-632, noted ACCC Journal, Issue 14, p 36 (April 1998).

- “causes or permits” another person to hold it out as the manufacturer.

Under sec 74A(4), an importer is deemed to be the manufacturer if at the time of import the manufacturer does not have a place of business in Australia.

Section 75AA defines the type of manufacturing activities caught by Part VA to include growing, extracting, producing, processing and assembling.

Section 75AJ provides that if the manufacturer is unidentified, the potential claimant can serve a written request to any or all known suppliers requesting them to identify the manufacturer of the goods.

If the manufacturer cannot be identified after 30 days, each supplier which did not respond to the request is deemed to have manufactured the goods: sec 75AJ(2).

Liability provisions

Part V Div 2A (§7-212) imposes liability in contract between manufacturer and consumer. In contrast, Part V imposes statutory liability on the manufacturer.

Part VA states that the manufacturer is liable to compensate:

- an “individual” (not a “consumer” as defined in sec 4B: §7-012) for loss suffered as a result of injury caused by defective goods: sec 75AD. If an individual dies because of the injuries, sec 75AD(f) and sec 75AH preserve existing laws — in this case the fatal accidents laws in each State and Territory,³⁵ which provide that certain dependants of the deceased may claim for specified classes of damages through the administrator or executor of the estate.
- a third person (other than the injured person) such as a bystander or the dependants of a person who is injured: sec 75AE.³⁶ Part VA does not create rights of a commercial nature, and losses caused by a business relationship between the injured person and the potential claimant are excluded by sec 75AE(1)(e). This denies claims by company directors, business partners and employees.
- a person for damage to personal, domestic or household goods caused by defective goods: sec 75AF. The damaged goods must not only have been of a “consumer” type, but they must have been used or intended for use by the claimant mainly for that purpose (sec 75AF(d)). Damage to commercial property is not covered by sec 75AF.
- a person for damage to land, buildings or fixtures (such as stoves, fixed bookshelves and light fittings: §3-080ff) acquired for personal use: sec 75AG. As with sec 75AF, damage to commercial property is

35. eg *Compensation to Relatives Act 1897* (NSW); *Fatal Accidents Act 1959* (WA); 1934 (Tas), based on *Lord Campbell's Act 1846* (Imp).

36. eg *Stegenga v J Corp Pty Ltd* (1999) ATPR §41-695 (third party unable to enforce commercial claim against fourth party under sec 75AE).

excluded and only loss brought about by damage to property of a kind ordinarily acquired for private use is recoverable.

Section 75AH provides that Div 2A does not repeal the fatal accidents legislation of each State and Territory (see above), and action may be taken under it whether or not the death was the result of the injuries caused by the defect.

Part VA aims at consumer protection, and sec 75AI provides that the liability provisions (sec 75AD, 75AE, 75AF and 75AG) do not apply if the loss could be recovered under workers' compensation or any international agreement.

If more than one party is liable to compensate the consumer for loss — such as a component manufacturer and the manufacturer of the finished goods — liability is “joint and several” (individual and collective: cf ¶10-240) under sec 75AM. The plaintiff can sue one or all of those responsible for the loss.

Section 75AN provides that if the loss arising under sec 75AD, sec 75AE, sec 75AF or sec 75AG was caused by both a defect and an act or omission by the plaintiff, the court will reduce the amount of compensation to reflect this. The reduction could be a complete disallowance of the claim because of culpable acts or omissions of the injured person, and parallels contributory negligence at common law (¶4-160).

Action must be commenced within three years of the loss, and within 10 years of the supply of the goods by the manufacturer: sec 75AO.

Section 75AQ provides that the ACCC can take action in a class action (¶7-770) on behalf of identified consumers who have suffered loss, with their written consent.

“Goods”

Section 4 of the *Trade Practices Act* states that “goods” include ships, animals, minerals, gas and electricity. “Goods” include component parts — this means that manufacturers of component parts which are incorporated into finished products may be liable to compensate injured claimants if the component goods contribute to or cause a defect in the finished goods.

Defences

Section 75AK sets out several defences for the manufacturer:

- the non-existent defect defence: sec 75AK(1)(a). The defect did not exist when the goods left the control of the manufacturer, defined as the “supply time” (sec 75AK(2)) — the manufacturer is not liable for matters beyond its control such as later improper use. To succeed on this defence, the manufacturer must show that the defective goods were defect-free when they left the control of the manufacturer, and it may have to provide evidence of the manufacturing process and quality control.

This defence can be relied on by a component manufacturer. If a component is incorrectly installed into a finished product and it acts in

a “defective” manner, the component manufacturer may be able to rely on sec 75AK, in particular sec 75AK(1)(d).

- the goods complied with a mandatory standard (such as a product safety standard or a product information standard: ¶7-495): sec 75AK(1)(b). The compliance must be the sole cause of the defect, and the manufacturer is not freed from liability where compliance is merely a partial cause of the defect. As defined in sec 75AA, a “mandatory standard” which sets only minimum performance requirements is not a “mandatory standard” for the purposes of Part VA.

If this defence is successful, the Commonwealth is liable to compensate the claimant under sec 75AL instead of the manufacturer.

- the “state of the art” or the “development risks” defence: sec 75AK(1)(c). The defect in the goods could not have been discovered in the light of current scientific and technical knowledge at the time the goods were supplied. The test is the objective state of scientific and technical knowledge and not the subjective knowledge of the individual manufacturer. To come within this defence, the manufacturer must keep up to date with advances in knowledge after it has first put the product into circulation.
- the component parts manufacturer is not liable if the finished goods are defective solely due to an act or omission of the manufacturer of the finished goods such as careless assembly, using an unsuitable component or incorrect or inadequate instructions: sec 75AK(1)(d). As noted above, the non-existent defect defence in sec 75AK(1)(a) may also be available to the component parts manufacturer.

Other defences include: the goods were not supplied by a “corporation” (within the extended meaning in the *Trade Practices Act 1974* (Cth): ¶7-220); they were not supplied in “trade or commerce” (¶7-220); they were not defective and/or they did not cause the plaintiff’s loss.

No exclusions

Part VA cannot be restricted, excluded or modified by contract, and any term of a contract which attempts to do so is void: sec 75AP. This is based on sec 68 (¶7-170).

Savings

Part VA is not intended to be a complete code on defective goods, and it saves other laws and remedies such as unconscionability, damages for economic loss (¶4-215) and the other sections of the *Trade Practices Act*: sec 75AR.

A consumer now only has to sue one contributing party and does not have to prove facts beyond its expertise. The onus of disproof passes to the manufacturer.

Manufacturers will have to take more care with their products, and the possibility of increased product liability raises issues of product viability.

Some products may be discontinued or recalled.³⁷ Because of the deemed manufacturer provisions, manufacturers may wish to distance themselves from other people's products: "home brands" may disappear. A supplier will need to identify the origin of all goods, because if it cannot identify the manufacturer, it will be deemed the manufacturer under sec 75AJ.³⁸

TRADE PRACTICES ACT CONSUMER PROTECTION

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37. eg Boas, G, *Part VA of the Trade Practices Act: a failure to adequately reform product liability law in Australia* (1994) 6 Bond LR 112; Pryles, M, *Product recalls in Australia* (1995) 69 ALJ 211; ¶7-495.

38. See *Trade Practices Amendment Act 1992* (Cth) *Explanatory Memorandum*; CCH *Australian Trade Practices Reporter*

¶24-000ff; Australian Consumers' Association, *An Arm and a Leg: The Human and Economic Cost of Unsafe Products*, Australian Consumers' Association, Marrickville, NSW, 1989; LRC, *Product Liability*, Issues Paper No 7, Sydney, February 1988; Travers, RC, *Australia's new product liability law* (1993) 67 ALJ 516.

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¶7-216 Introduction of the *Trade Practices Act*. The aim of the *Trade Practices Act 1974* (Cth), as discussed at ¶8-010, is to provide for regulation of business and trade practices. In addition to regulating anti-competitive and anti-business activities (such as refusal to supply and abuse of a strong market position), the Act provides protection for business and domestic consumers.

¶7-220 *Trade Practices Act* and the Commonwealth Constitution. As discussed at ¶1-475, the colonial (later State) politicians and representatives who drafted the Commonwealth Constitution in the 1890s jealously guarded their existing colonial powers, and as a result the Commonwealth's powers to legislate are limited to those set out in the Constitution. There is no power to regulate trade practices as such, but instead the *Trade Practices Act* is based ingeniously on a number of specific Commonwealth powers:³⁹

1. *Corporations*. The conduct and commercial activities of foreign, trading or financial corporations is a Commonwealth power under sec 51(xx) of the Constitution (set out at ¶1-475, and discussed further at ¶9-370).
2. *Persons*. The conduct of persons other than corporations is also a Commonwealth power where there is:⁴⁰
 - (1) "[t]rade and commerce with other countries, and among the States" (Constitution sec 51(i): ¶1-475; ¶7-250); trade and commerce is widely understood in case law to include the movement

39. The failure of earlier Commonwealth trade practices legislation following constitutional challenges has shaped the *Trade Practices Act*: sec 5 and 8 of the *Australian Industries Preservation Act 1906* were found to intrude into the area of purely intrastate trade and commerce and were therefore beyond Commonwealth power: *Huddart Parker & Co Pty Ltd v Moorehead* (1908) 8 CLR 330 (High Court). *Trade Practices Act 1965* found to be invalid: *Strickland v Rocla Concrete Pipes Ltd* (1971) 124 CLR 468. Section 7 of that Act provided that practices examinable under the Act included those engaged in in the course

of trade or commerce with other countries or between the States and on the part of a foreign corporation or a trading or financial corporation formed within the limits of the Commonwealth. The High Court found the effect of sec 7 was that activities engaged in in intrastate trade or commerce and by corporations outside the constitutional definition were caught by the Act and were therefore unconstitutional.

40. *Trade Practices Act* sec 6(2)-(4) extends the operation of the Act beyond corporations to persons, including sole traders and partnerships.

of goods or persons, transportation by land, sea or air, sales of goods and negotiations, and related dealings;

- (2) trade or commerce within a Territory (ie the NT and the ACT), between a State and a Territory or between two Territories (based on the Commonwealth's Territories power in Constitution sec 122: ¶1-475);
- (3) trade or commerce by way of supply of goods or services to the Commonwealth or to an authority or instrumentality of the Commonwealth (Constitution sec 52: ¶1-475);
- (4) use of postal,⁴¹ telegraphic, telephone services or a radio or television broadcast in the case of conduct infringing Part V Div 1 (Unfair Practices) and Div 1A (Product Safety and Product Information) but not Div 2 (implied terms) (based on the Commonwealth's post and telegraph power in Constitution sec 51(v): ¶1-475);⁴²
- (5) misleading conduct under TPA sec 55 to which the Paris Convention for the Protection of Industrial Property applies (¶7-410) (based on the Commonwealth's external affairs power in Constitution sec 51(xxix): ¶1-475).

In the case of any inconsistency with State or Territory laws, sec 109 of the Constitution provides that the Commonwealth law shall prevail (¶1-475). In fact, sec 75 of the TPA expressly preserves the concurrent operation of State or Territory law. The constitutional defence of inconsistency may therefore fail in a prosecution for breach of a State or Territory consumer protection law.⁴³

Section 86 of the *Trade Practices Act* confers primary trade practices jurisdiction on the Federal Court (¶1-100—¶1-120).⁴⁴

41. Sec 6(3)(a): includes the sending of an email: *Dataflow Computer Services Pty Ltd v Goodman* (1999) ATPR ¶41-730; (see ¶5-015).

42. "[A]fter it became clear that the booklets were sent by post, the respondent no longer pressed its contention that, as it was not a corporation, the court did not have jurisdiction under the TPA: see 6(3) of the TPA": *Nixon v Slater & Gordon* [2000] FCA 531; (2000) Aust Torts Reports ¶81-565 at para [26].

43. As in *Grace Bros Pty Ltd v Magistrates of the Local Courts of New South Wales* (1989) 23 FCR 68; (1990) ATPR ¶40-999 (breach of *Consumer Protection Act 1969* (NSW) sec 32: no inconsistency with TPA sec 53 (eb)).

44. The declaring of the cross-vesting scheme to be unconstitutional by the High Court in *Re Wakim; ex parte McNally* (1999) 73 ALJR 839 (¶1-100) led to amendments to sec 86A and 150D of the *Trade Practices Act* effective 23 December 1999.

Section 2A provides that the Act binds the Commonwealth (ie the “Crown”) in so far as it carries on a business.⁴⁵ Section 2B provides that the Act applies to State and Territory government business activities.⁴⁶

¶7-230 Consumer protection provisions. Although Part V is headed “Consumer Protection”, the heading cannot impose an unnaturally constricted meaning on the words in the sections in Part V (¶1-260). The prohibition of misleading or deceptive conduct in sec 52 (¶7-250) does not target consumers alone and could be equally enforced by competitors or suppliers. The section is not penal or criminal and breach does not attract a fine. However, an aggrieved person under sec 52 can seek an injunction (sec 80: ¶8-810), corrective advertising (sec 80A: ¶8-830), damages (sec 82: ¶8-840) and “other orders” (sec 87: ¶8-860).

Sections 53-64 inclusive contain a series of provisions aimed at specific conduct. Companies or persons in breach of those sections are liable to criminal prosecution as well as injunction, damages and ancillary orders by the court. Ancillary orders may involve, for example, refunds of money, and the publication of corrective advertising may be required (sec 80, 80A). The specific provisions of Part V are discussed in detail below (¶7-250ff).

However, sec 65A of the Act excludes the application of specified provisions of the Act⁴⁷ to ordinary items of news and comment from a “prescribed information provider” — print or electronic media — defined to include licensed radio and TV stations (¶8-910).

Section 75 states that the consumer protection provisions are not intended to exclude or limit the concurrent operation of State or Territory laws; however, a company or person cannot be convicted of the same offence under both laws.

The remedies available under the Act, and the corresponding defences, are discussed at ¶8-750—¶8-930.

Because of the constitutional limitations on the federal government’s power to pass complete national consumer protection laws (¶7-220), the States/Territories have passed uniform provisions mirroring the consumer protection provisions of the *Trade Practices Act*. The *Fair Trading Act 1987* (NSW); 1999 (Vic), 1987 (SA), 1987 (WA), 1989 (Qld), 1990 (Tas), 1992 (ACT) and the *Consumer Affairs and Fair Trading Act 1990* (NT) — referred to where appropriate in the following pages — would catch conduct, for

45. Disposal of assets of the Australian Government Publishing Service (AGPS) is not conduct in the carrying on of a business under sec 2A and therefore sec 52 does not apply to alleged misleading conduct by the Commonwealth: *JS McMillan Pty Ltd v Commonwealth of Australia* (1997) ATPR (Digest) ¶46-175.

46. The facts giving rise to *Bass v Permanent Trustee Company Ltd* (1999) 73 ALJR 522, (1999) ATPR ¶41-682 which held that sec 6(3) and 75B(1) did not apply to a State government because it was not a “person”, took place before sec 2B was passed in 1996.

47. Sec 52, 53, 53A, 55, 55A and 59.

example, by an intra-State or Territory sole trader dealing face-to-face without use of the telephone or postage.

The conditions and warranties from traditional Sale of Goods Act legislation implied by the TPA Part V Div 2 and 2A require a “corporation” (with its constitutional extension: ¶17-220) as supplier, etc and a “consumer” as set out in sec 4B as buyer (¶17-012). In contrast, most of the sections in TPA Part V Div 1, Unfair Practices⁴⁸ do not require dealing with a “consumer” — business v business cases tend to dominate reported Part V Div 1 cases (eg ¶17-280).

¶17-240 Consumer protection: financial services. Consumer protection laws regarding financial services previously covered by the *Trade Practices Act* were re-enacted in the *Australian Securities and Investments Commission Act 1989* (Cth) (the “ASIC Act”) as from 1 July 1998.⁴⁹ Their administration passed from the ACCC to ASIC. Section 52 is re-enacted as sec 12DA; sec 53 is re-enacted as sec 12DB etc.

A “financial service” is defined in the ASIC Act sec 12BA to mean:

“... a service that:

- (a) consists of providing a financial product; or
- (b) is otherwise supplied in relation to a financial product.”

A “financial product” is defined in sec 12BA to mean:

- “(a) a facility for taking money on deposit (otherwise than as part-payment for identified services) made available in the course of conducting a banking business within the meaning of the *Banking Act 1959*; or
- (b) a security; or
- (c) a futures contract; or
- (d) a contract of insurance (including a life policy or a sinking fund policy within the meaning of the *Life Insurance Act 1995*); or
- (e) a retirement savings account within the meaning of the *Retirement Savings Accounts Act 1997*; or
- (f) a superannuation interest within the meaning of the *Superannuation Industry (Supervision) Act 1993*;

but does not include a foreign exchange contract.”

This definition leaves consumer protection with respect to non-financial services such as guarantees (¶13-360) and foreign exchange contracts (¶16-060) in the *Trade Practices Act*.

48. With the exception of sec 57 and 60.

49. By the *Financial Sector Reform (Consequential Amendments) Act 1998* (Cth), one of the reforms proposed by the Wallis Committee (1997: ¶16-020). The equivalent sections of the ASIC Act

are noted in this chapter in the footnotes to the relevant sections of the TPA. TPA sec 51AF provides that TPA Pt V does not apply “to the supply, or possible supply, of services that are financial services”; ¶17-310.

¶7-250 Misleading or deceptive conduct: sec 52. Part V Div 1 of the Act is entitled “Consumer Protection — Unfair Practices”. Section 52 states:⁵⁰

“52(1) A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

52(2) Nothing in the succeeding provisions of this Division shall be taken as limiting by implication the generality of subsection (1).”

Section 52 establishes a standard of conduct. It does not create liability, but failure to observe the standard of conduct required can give rise to liability under the Act, as set out at ¶8-750—¶8-865, subject to the defences at ¶8-870—¶8-930.

Section 52 catches

- (1) conduct (by a “corporation” or person, as extended by sec 6),
- (2) in trade or commerce (¶7-220) which is
- (3) misleading or deceptive.

Once these three elements are present, any person may bring an action against the corporation engaging in the misleading or deceptive conduct. The section is not limited to conduct which is actually misleading, but it must be capable of misleading the public at large, or an identifiable section of it.

The remedies which are available to a person who suffers loss as a result of a breach of sec 52 are discussed at ¶8-750—¶8-930.

(1) *Conduct falling within sec 52.* Section 52 has become the most litigated section of the Act. In the *Taco Bell case*,⁵¹ a majority of the Full Federal Court (*Deane and Fitzgerald JJ*) set out what it described as propositions “affording guidance” in ascertaining whether conduct falls within sec 52. These were outlined thus:

“First, it is necessary to identify the relevant section (or sections) of the public (which may be the public at large) by reference to whom the question of whether conduct is, or is likely to be, misleading or deceptive falls to be tested... .

Second, once the relevant section of the public is established, the matter is to be considered by reference to all who come within it, ‘including the astute and the gullible, the intelligent and the not so intelligent, the well educated as well as the poorly educated, men and women of various ages pursuing a variety of vocations’

50. Also *Australian Securities and Investments Commission Act 1989* (Cth) (the “ASIC Act”) sec 12DA in relation to the conduct of financial institutions; *Fair Trading Act 1987* (NSW) sec 42; 1999 (Vic) sec 9-11; 1989 (Qld) sec 38; 1987 (SA) sec 56; 1987 (WA) sec 10; 1990

(Tas) sec 14; 1992 (ACT) sec 12; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 42.

51. *Taco Company of Australia Inc v Taco Bell Pty Ltd* (1982) ATPR ¶40-303 at pp 43,751-43,752.

Thirdly, evidence that some person has in fact formed an erroneous conclusion is admissible and may be persuasive but is not essential. Such evidence does not itself conclusively establish that conduct is misleading or deceptive or likely to mislead or deceive. The Court must determine that question for itself. The test is objective ...

Finally, it is necessary to inquire why proven misconception has arisen ... The fundamental importance of this principle is that it is only by this investigation that the evidence of those who are shown to have been led into error can be evaluated and it can be determined whether they are confused because of misleading or deceptive conduct on the part of the respondent."

The second proposition may require some modification in light of comments made by Gibbs CJ in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*⁵² that the "heavy burdens which the section creates cannot have been intended to be imposed for the benefit of persons who fail to take reasonable care of their own interests".

— *Case example* —

The *Taco Bell* case involved three Mexican food restaurants operating under the name "Taco Bell". The Bondi restaurant had been known by that name since 1976. The other restaurants were owned by a US chain which in 1981 changed the name of an existing restaurant and opened another under the name "Taco Bell". Both companies complained of the use of the name by the other.

The Full Federal Court reached the conclusion that by the time the US chain called its restaurants by the name "Taco Bell" the Bondi restaurant had acquired a reputation throughout Sydney in that name. The cause of any actual or likely misconception was the use of the name by the US corporation.

Taco Company of Australia Inc v
Taco Bell Pty Ltd⁵³ —

(2) *Conduct in "trade or commerce"*. Section 52 is in part built on the Commonwealth's power under the Constitution over interstate and international "trade and commerce" (sec 51(1): ¶1-475) and, if necessary, constitutional case law can define the meaning of "trade" or "commerce". Not all conduct that is misleading or deceptive is conduct *in* trade or commerce, but only "conduct which is itself an aspect or element of activities or transactions which, of their nature, bear a trading or commercial character".⁵⁴ For example, a prospectus and other communications from directors to company members about company affairs is conduct in trade or commerce.⁵⁵

The following conduct falls outside sec 52 as it is not in "trade or commerce":

52. (1982) 149 CLR 191 at p 199; (1982) ATPR ¶40-307 at p 43,783.

53. (1982) ATPR ¶40-303.

54. *Concrete Constructions (NSW) Pty Ltd v Nelson* (1990) 169 CLR 594 at p 603;

(1990) ATPR ¶41-022 at p 51,364 (High Court).

55. *Fraser v NRMA Holdings Ltd* (1994) ATPR ¶41-436 (the "demutualization" case: ¶7-280) per Gummow J.

- a private sale of property by an individual unless in a business context;⁵⁶
- a statement of government policy made by a Minister;⁵⁷
- claims made in the course of a lecture that boat-shaped geological formations in Turkey do or could contain the remnants of Noah's Ark, thereby providing tangible evidence of the literal truth of the account of the great flood in the Old Testament. This was because the lecturer was not paid to deliver the lectures, the sponsoring organisation was staffed by volunteers, and no business activities were being promoted by the lectures.⁵⁸
- a media release by the ACCC describing court proceedings against the plaintiff. Although the ACCC does earn some revenue from the sale of publications etc, the press release must be published "in" that trade or commerce.⁵⁹
- internal communications within a corporation.

— *Case example* —

A building worker, wrongly informed by the company's foreman that a grate was bolted, was injured when the grate gave way. Because the foreman's information (his "misleading or deceptive conduct") was held not to be within "trade or commerce", the worker's sec 52 claim for compensation was unsuccessful. "Trade or commerce" was held by the High Court to exclude inaccurate information given by one employee to another, and to refer only to conduct which is an aspect of the corporation's trading or commercial activities. As another indication of what is not "trade or commerce" and therefore outside the scope of the *Trade Practices Act*, the court gave the example of the failure by a driver to give a correct hand signal while driving a truck in the course of a corporation's haulage business. In contrast, driving a truck for delivery of goods to a consumer is "trade or commerce", and to drive a truck with a competitor's name on it in order to mislead the consumer may constitute misleading or deceptive conduct in "trade or commerce".

— *Concrete Constructions (NSW) Pty Ltd v Nelson*⁶⁰ —

At the very time when many jurisdictions are introducing no fault schemes for road accidents (§17-730, §17-050) and industrial accidents (§17-065), a decision in favour of the employee would have established a precedent for sec 52 being used for personal injury claims in industrial and motor accident claims.

56. eg *Argy v Blunts* (1990) 26 FCR 112; (1990) ATPR ¶41-015 (an individual's sale of his place of residence which is not used for business and which does not constitute his trading stock); ¶7-280.

57. *Unilan Holdings Pty Ltd v Kerin* (1992) 35 FCR 272; (1992) ATPR ¶41-169 (speech by Minister in 1990 that reserve

price scheme for wool would be maintained; scheme suspended in 1991).

58. *Plimer v Roberts* (1998) ATPR ¶41-602.

59. *Giraffe World Australia Pty Ltd v ACCC* (1999) ATPR ¶41-669, ¶7-280.

60. (1990) 169 CLR 594; (1990) ATPR ¶41-022.

(3) *Conduct which is misleading or deceptive.* Various cases have dealt with the meanings of “misleading” and “deceptive”.

In *Weitmann v Katies Ltd*,⁶¹ *Franki J* resorted to the *Oxford Dictionary*, stating:

“The most appropriate meaning for the word ‘deceive’ ... is: ‘to cause to believe what is false; to mislead as to a matter of fact, to lead into error, to impose upon, delude, take in’.

The most appropriate definition in that dictionary for the word ‘mislead’ is: ‘to lead astray in action or conduct; to lead into error, to cause to err’.”

The addition of the words “likely to mislead or deceive” in 1977 means that it is unnecessary to prove that the conduct actually did mislead or deceive anyone, so long as there is a real and not a remote chance of it.⁶² The words “likely to mislead or deceive” raise the question of whether conduct which caused confusion would fall within the section.

— *Case example* —

McWilliam’s wine in two-litre bottles was described as “Big Mac” across the top of an advertisement for the wine. McDonald’s fast food chain marketed a particular hamburger under that name and claimed that the conduct of McWilliam’s fell within sec 52.

On appeal, *Smithers J* found that even though McWilliam’s conduct might cause confusion in the mind of persons as to whether there was a business connection between the two companies, such a person was not misled. Any misunderstanding occurring was a consequence of a “misunderstanding by observers induced by erroneous assumptions on their part”.

_____ *McDonald’s System of Australia Pty Ltd v
McWilliam’s Wines Pty Ltd*⁶³ —

Other important principles which have emerged following judicial consideration of the section are:

- Error or an erroneous assumption on the part of consumers will not, of itself, prove contravention of sec 52. In order to show that conduct is misleading or deceptive, it must be shown that it has been the cause of the error or is likely to cause error.
- Conduct which merely causes some uncertainty in the minds of relevant members of the public does not infringe sec 52. The idea of misconception caused by factors other than the conduct complained of was considered in the *Parkdale case*.

61. (1977) 29 FLR 336 at p 343; (1977) ATPR ¶40-041 at p 17,444.

62. eg *ASC v Nomura International plc* (1999) ATPR (Digest) ¶46-188 at p 52,322.

63. (1979) 49 FLR 455; (1980) ATPR ¶40-188.

— Case example —

Parkdale appealed to the High Court from a judgment of the Full Federal Court which had granted an injunction restraining it from manufacturing lounge suites deceptively similar to those of Puxu. Puxu had manufactured those suites for two years, and sold them under the name "Post & Rail". The items in its "Contour" range were distinctive in design and appearance. At a later time Parkdale began to manufacture its "Rawhide" range of products which closely resembled the "Contour" range. Labels were attached to the "Rawhide" range clearly stating that they were manufactured by Parkdale as part of that range. The labels were attached to the chairs as was the normal practice of furniture manufacturers. The labels could, however, be tucked away from sight or easily removed. A majority of the High Court allowed the appeal. *Mason J* found that the conduct of Parkdale did not fall within sec 52(1) because it merely caused consumers to wonder whether the products came from the same source. *Gibbs CJ* and *Brennan J* found that the conduct was not the *cause* of the misconception as the goods were properly labelled.

*Parkdale Custom Built Furniture Pty Ltd v
Puxu Pty Ltd*⁶⁴ —

- Contravention of sec 52 may be proved without there being knowledge or intention on the part of the defendant: "The section should be understood as meaning precisely what it says and as involving no questions of intent upon the part of the corporation whose conduct is in question."⁶⁵
- There must be reliance on the misleading or deceptive conduct. The mere possibility that a misrepresentation contravening sec 52 may have induced a course of action by the representee could never of itself attach liability to the making of it.⁶⁶
- The loss must be caused by the conduct of the defendant.⁶⁷ Section 52 provides no remedy for a person who incurs loss as a result of failure to take care of their own interests.
- Loss or damage is unnecessary to proof of contravention.⁶⁸
- Who is likely to be misled? The identification of "the relevant section ... of the public" is directed to finding those who are likely to be misled or deceived. This section of the public can be limited geographically or

64. (1982) 149 CLR 191; (1982) ATPR ¶40-307.

65. See, eg *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Pty Ltd* (1978) 140 CLR 216 at p 228; (1978) ATPR ¶40-067, per *Stephen J* at p 17,690 (¶12-050).

66. *Ricochet Pty Ltd v Equity Trustees Executor and Agency Company Ltd* (1993) ATPR ¶41-236.

67. *Leda Holdings Pty Ltd v Oraka Pty Ltd* (1998) ATPR ¶41-601.

68. See, eg, *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191; (1982) ATPR ¶40-307; *Yorke v Lucas* (1985) 158 CLR 661; (1985) ATPR ¶40-622 (High Court).

otherwise.⁶⁹ The appropriate standard against which to measure conduct in the light of sec 52 varies according to the characteristics of the section of the public making up the exposed group. Consideration of reputation has proved to be a useful tool in determining exactly whom conduct might mislead or deceive.⁷⁰

- Section 52 is not available as a defence in respect of a claim for damages.⁷¹
- Section 52 does not have any “due diligence” defences,⁷² as the defences available in sec 85 do not apply to it (¶8-870—¶8-930). An honest belief in the statement is not a defence if the statement breaches sec 52.⁷³
- Silence may be misleading or deceptive, but sec 52 does not create a “duty to disclose”. If there is a duty to disclose, it does not arise under sec 52 and it must arise from another source such as the relationship between the parties and the context of their dealings. Section 52 does not strike at the traditional secretiveness of the bargaining process: “Traditional bargaining may be hard, without being in the statutory sense misleading or deceptive. No one expects all the cards to be on the table. But the bargaining process is not therefore to be seen as a licence to deceive”.⁷⁴

— Case examples —

The Aboriginal insurance cases. Insurance agents from at least three different insurers targeted Aboriginal Australians in remote outback communities with superannuation and investment policies. With promises such as a refund on their money within two years, the agents signed up uneducated stockmen and other rural workers and arranged monthly payments by bulk billing through their pay offices. The agents’ promises rendered their respective insurance companies liable for their actions: ¶17-500ff. Complaints to the TPC resulted in court proceedings against the insurers by the TPC under sec 52 and the precursor to sec 51AB (¶5-755). A court-indorsed settlement of \$1.5 million was reached with Colonial Mutual in April 1992 to be returned to about 2,000 policyholders in 22 remote communities. Under the settlement, the insurer agreed to refund all premiums paid to policyholders

69. It may, for example, be constituted by a public of “one” (a bank’s credit report): *National Australia Bank Ltd v Cunningham* (1990) ATPR ¶41-047. It may be constituted by a public of millions (newspaper readers): *Global Sportsman Pty Ltd v Mirror Newspapers Ltd* (1984) 2 FCR 82; (1984) ATPR ¶40-463.

70. See, for example, *Taco Company of Australia Inc v Taco Bell Pty Ltd* (1982) ATPR ¶40-303.

71. *Bank of New Zealand v Spedley Securities Ltd (in liq)* (1992) 27 NSWLR 91, noted (1992) 66 ALJ 541.

72. Compare Corporations Law sec 731-733: ¶7-280.

73. *RAIA Insurance Brokers Ltd v FAI General Insurance Co Ltd* (1993) 41 FCR 164 at p 165; (1993) ATPR ¶41-225 at p 41,088; McGregor, R, *Section 52 — is honesty a defence?*, LJ, Vol 70, No 3, p 46 (March 1996).

74. *Poseidon Ltd v Adelaide Petroleum NL* (1992) ATPR ¶41-164, per Burchett J at p 40,227; see further Skapinker, D, *Silence is golden — or is it?* (1995) 69 ALJ 165; Duggan, A, Bryan, M and Hanks, F, *Contractual Non-Disclosure*, Longman Professional, 1994.

wishing to cancel, to set up a trust fund to further the consumer education of Aboriginal Australians and to conduct a rigorous compliance program with its staff to upgrade compliance with the Act. By co-operating with the TPC, the insurer avoided potentially lengthy and costly legal proceedings.

*TPC v The Colonial Mutual Life Assurance Society Ltd*¹ —

The description by Qantas that certain seats were non-smoking seats was not misleading or deceptive even though there was some smoke in the area near the smoking seats. As in a restaurant with smoking and non-smoking areas, there can be no guarantee that the air in a plane with smoking and non-smoking areas will be totally smoke-free.

*Qantas Airways Ltd v Cameron*² —

¶7-280 Application of sec 52 (business v business). Although it appears in Part V entitled “Consumer Protection”, sec 52 which contains no “consumer” limitation (¶7-230, ¶7-250) has become the section of the Act most used by competitor against competitor and by business against business.

The scope of sec 52 misleading or deceptive conduct cases now includes the following:

(1) Action for misrepresentation by a bidder at an auction,³ and misrepresentation on the purchase or transfer of a business,⁴ crops,⁵ real estate,⁶ a lease,⁷ a franchise,⁸ a car,⁹ lease of a motor vehicle,¹⁰ and other

1. Settled 9 April 1992, noted in TPC Bulletin, No 65, p 21 (March-April 1992). See further TPC, *Taking Advantage*, 1994.

2. (1996) ATPR ¶41-487.

3. *Futuretronics International Pty Ltd v Gadzhis* [1992] 2 VR 217; (1990) ATPR ¶41-049 (oral bid implied representation that bid was genuine and that bidder intended to be bound by auction conditions; unsuccessful case under *Fair Trading Act 1985* (Vic) sec 11); noted, McPhee, N, *Vendor bids and the conduct of auctions* (1993) 67 LIJ 50; ¶5-210.

4. eg *Fencott v Muller* (1983) 152 CLR 570; (1983) ATPR ¶40-350; *Effem Foods Pty Ltd v Lake Cumbeline Pty Ltd* (1999) ATPR ¶41-686 (High Court decision against the alleged representations).

5. eg *TPC v Friendship Aloe Vera Pty Ltd* (1988) ATPR ¶40-892.

6. eg *Argy v Blunts* (1990) 26 FCR 112; (1990) ATPR ¶41-015, noted (1990) 64

ALJ 498 (zoning dispute affecting \$3m Sydney Harbour waterfront property); *Hanave Pty Ltd v LFOT Pty Ltd* (1999) ATPR ¶41-687, noted (2000) 74 ALJ 14.

7. eg *IOOF Australia Trustees (NSW) Ltd v Tantipech* (1998) ATPR ¶41-652 (¶7-281) (representations on occupancy levels of shopping complex); Pengilly, W, *Restrictive and unfair practices in commercial leasing* (1990) 18 ABLR 153.

8. eg *Crawford v Parish* (1991) 105 FLR 361; (1992) ATPR (Digest) ¶46-087 (burglar alarm franchise) (set out at ¶5-705); *Nescor Industries Group Pty Ltd v Miba Pty Ltd* (1998) ATPR ¶41-609; ¶9-986.

9. *Jones v West Star Motors Pty Ltd* (1995) ATPR ¶41-447 (Court of Appeal, Qld) (no misleading representation about fixing defects in car, as seller had attempted to fix them); ¶7-070.

10. *Gardiner v Suttons Motors (Homebush) Pty Ltd* (1983) 71 FLR 294; (1983) ATPR ¶40-372.

assets,¹¹ the value of shares and the existence of prospective buyers for a business,¹² the amount of council rates applying to an investment property,¹³ the true terms of a loan and mortgage¹⁴ and the true terms of a guarantee.¹⁵ Silence may constitute misrepresentation at common law (¶5-700), and may be relied on to show a breach of sec 52 when the circumstances give rise to an obligation to disclose relevant facts,¹⁶ but not every commercial situation involves a duty of disclosure and not every non-disclosure can be characterised as misleading or deceptive.¹⁷

— *Case example* —

AMP “80/20” insurance. AMP was charging insureds a withdrawal fee of thousands of dollars even though its prospectus and insurance policy document stated that no “withdrawal fee” would be charged after two years. Proposed legal proceedings by the Commission under sec 52 were settled: the Commission’s concerns over the policy were met, \$50m would be delivered to some 286,000 policy holders, and AMP agreed to provide \$100,000 for a community education TV program and \$70,000 towards the Commission’s costs.

— *The AMP case*¹⁸ —

(2) Action by competitor against competitor,¹⁹ including cases on “knocking copy” (that is, an advertisement directly or inferentially downgrading the product of a rival).²⁰ Comparative advertising can promote the interests of the advertiser and affect competition, so “[w]hen a company engages in

11. *Schepis v Elders IXL Ltd* (1987) ATPR ¶40-759 (automatic irrigation system), also noted at ¶7-090; *Chippendale Printing Co Pty Ltd v Spunaline Pty Ltd* (1985) ATPR ¶40-631.
12. *Gaffikin Marine Pty Ltd v Princes Street Marina Pty Ltd* (1995) ATPR (Digest) ¶46-149 (¶8-840).
13. *Voss Real Estate v Schreiner* (1998) ATPR ¶41-627.
14. eg *Money v Westpac Banking Corporation* (1988) ATPR ¶40-894 (¶8-860); *Figgins Holdings Pty Ltd v Commonwealth of Australia* (1995) ATPR ¶41-382.
15. eg *Lisciandro v Official Trustee in Bankruptcy* (1995) ATPR ¶41-436, which applied sec 52 and the unconscionability principles of *Amadio’s case* (¶5-730) to a guarantee entered by a trusting but ignorant friend.
16. eg *Edgar v Farrow Mortgage Services Pty Ltd (in liq)* (1992) ATPR (Digest) ¶46-096 (financier’s failure to disclose its own financial difficulties as reason for its

inability to continue in an agreement to finance a property development was conduct likely to mislead or deceive); *Demagogue Pty Ltd v Ramensky* (1993) 39 FCR 31; (1993) ATPR ¶41-203 (“off plan” unit had no road access).

17. eg *General Newspapers Pty Ltd v Telstra Corp* (1993) 45 FCR 164; (1993) ATPR ¶41-274 (non-disclosure of matters Telecom was entitled to keep to itself; also no breach of sec 46: ¶8-300).
18. Discussed in TPC Bulletin, No 80, p 31 (February 1995).
19. eg *Glev Pty Ltd and Glev Franchises Pty Ltd v Kentucky Fried Chicken Pty Ltd* (1994) ATPR ¶41-299 (Pizza Haven v KFC: comparative advertising of fast food).
20. eg *Eveready Australia Pty Ltd v Gillette Australia Pty Ltd* [1999] FCA 1824; (2000) ATPR ¶41-751 (Eveready v Duracell batteries; misleading comparison between zinc carbon batteries and alkaline batteries).

comparative advertising, particular care is required to ensure the correctness of the advertising.²¹

(3) Action for the protection of a face,²² character,²³ name,²⁴ word,²⁵ trade mark,²⁶ acronym and associated logo,²⁷ any images connected with the Sydney Olympics (¶7-330), and in conjunction with or as an alternative to the tort of passing off.²⁸

— *Case examples* —

The C.P.A. case

Advertisements were run in the *Australian Financial Review* in March 1987 by the Federation of Australian Accountants, inviting accountants to join the Federation and, on passing its examinations, to increase their status to "C.P.A." (with full stops — nowhere set out in full). These were successfully restrained by the Australian Society of Accountants under sec 52, 53 (subsection not specified: ¶7-290ff) and the tort of passing off (¶12-030), on the grounds that the Society was the only body which could confer "CPA" (no stops, no space) status on members of the accounting profession. Evidence was presented by the Society as to its \$3m investment over the previous three years in establishing the status of its qualification of Certified Practising Accountant (CPA) and that, as a body the antecedents of which went back to 1887, and with at the time of the case 53,000 members, a staff of 160 and a budget of \$17m spent annually on its professional objects alone, it was the only accounting body which could confer such qualification. The Federation's C.P.A. qualification was found to be likely to mislead both students seeking accounting qualifications, and users of accounting services, into believing

21. *Colgate-Palmolive Pty Ltd v Smithkline Beecham Holdings (Australia) Ltd* (1997) ATPR ¶41-579 at p 44,026 (toothpaste v toothpaste).
22. *eg Olivia Newton-John v Scholl-Plough (Australia) Ltd* (1986) ATPR ¶40-697 ("Olivia? No. Maybelline!").
23. *eg Fido Dido Inc v Venture Stores (Retailers) Pty Ltd* (1988) ATPR ¶40-912.
24. *eg Talmax Pty Ltd v Telstra Corporation Ltd* (1996) ATPR ¶41-535 (name and photo of Olympic swimmer Kieren Perkins used without permission); *Prospero Publishing Pty Ltd v Rumcoast Holdings Pty Ltd* [2000] WASCA 61; (2000) ATPR ¶41-762 ("Scoop" (existing lifestyle magazine) v "The Scoop" (new sexually explicit magazine)); ¶12-050.
25. *eg Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Pty Ltd* (1978) 140 CLR 216; (1978) ATPR ¶40-067; *Aerospatiale Societe Nationale Industrielle v Aerospatiale Helicopters Pty Ltd* (1986) 11 FCR 37; (1986) ATPR ¶40-700, noted (1986) 60 ALJ 680. See further ¶12-050.
26. *eg Campomar Sociedad, Limitada v Nike International Ltd* [2000] HCA 12; (2000) 74 ALJR 573; (2000) ATPR (Digest) ¶46-201 (Nike athletics v Nike cosmetics); *The Coca-Cola Company v All-Fect Distributors Ltd t/a Millers Distributing Company* (2000) ATPR ¶41-735 (Coca-Cola v Cola confectionery); ¶3-650.
27. *eg Targetts Pty Ltd v Target Australia Pty Ltd* (1993) ATPR ¶41-231 (Targetts Launceston obtained court order to restrain mainland trader Target from using name "Target" or its logo within 30km of Launceston).
28. *eg Apand Pty Ltd v The Kettle Chip Company Pty Ltd* [1999] FCA 483; (1999) 88 FCR 568 ("The Kettle Chip" v "Country Kettle" chips: ¶12-030; ¶12-050); *Dr Martens Australia Pty Ltd v Rivers (Australia) Pty Ltd* [1999] FCA 1655; (2000) ATPR ¶41-734, noted (2000) 7 CCLJ 287 (no passing off by cheaper look-alike shoes).

some connection existed between the Federation's C.P.A. and the Society's CPA; accordingly, the Federation's argument (inter alia) that C, P and A were just letters widely used, over which no proprietary interest could be held, was rejected.

*Australian Society of Accountants
v Federation of Australian Accountants Inc*²⁹ —

The Crocodile Dundee cases

The record-breaking 1986 Australian movie "Crocodile Dundee" starring actor Paul Hogan established strong images which were tempting to unauthorised unrelated businesses but which were disapproved of by interests associated with the film:

Case 1. Paul Hogan and the owners of the merchandising rights in the film succeeded in restraining under the tort of passing off (¶12-030) the operator of two shops (one in Brisbane; the other at Surfers Paradise) called Koala Dundee and Dundee Country from the use of images associated with the film such as a koala in "Crocodile Dundee" get-up (bush hat with teeth in the band, sleeveless vest and knife). Because of the successful passing off claim, the claim under sec 52 (that the retailers were connected with the film by indorsement, affiliation, franchise, licence, investment, sponsorship or approval) did not have to be considered. However, the sec 52 claim would probably have failed: other sec 52 merchandising cases involving an association with an invented character and otherwise unrelated goods generally fall into the category of causing confusion rather than being inherently confusing (¶7-250).

*Hogan v Koala Dundee Pty Ltd*³⁰ —

Case 2. Paul Hogan and the owners of the copyright in the film also gained an injunction, upheld by the Full Court, this time for breach of sec 52 as well as for the tort of passing off (¶12-030) to restrain further advertising of a TV commercial and display of posters on buses and trams for Grosby Leatherz men's shoes. The TV commercial was consciously designed as a send-up of the knife scene in the movie — "He's wearing leather shoes." "You call those leather shoes? Now these are leather shoes ...". An injunction to restrain further advertising was issued because of the likelihood of potential purchasers being misled or deceived into believing that the shoes were in some way connected with the film, that a licence for marketing had been given and that Paul Hogan had agreed to associate himself with them. In contrast to Case 1, and recognising that analysis of conduct that is misleading or deceptive is a question of fact, the association in Case 2 was of a higher level as it did more than cause confusion or an erroneous assumption on the part of consumers: it therefore constituted a breach of sec 52.

*Pacific Dunlop Ltd v Hogan*³¹ —

29. (1987) ATPR ¶40-796; appeal dismissed (1988) ATPR (Digest) ¶46-044.

30. (1988) 20 FCR 314; (1988) ATPR ¶40-902, noted (1989) 63 ALJ 281.

31. (1989) 23 FCR 553; (1989) ATPR ¶40-948, noted (1989) 63 LIJ 805.

Teenage Mutant Ninja Turtles. A permanent injunction and damages of \$10,000 were awarded to the owner/licensee against D — the directors of the same defendant as in the INXS case below — to restrain further production and marketing by D of pirate Turtle T-shirts and similar “gear” showing the Turtles smoking marijuana. D’s conduct was found to mislead or deceive the public into believing the products were authorised. The damages were awarded for D’s damaging way of drawing attention away from the licensee to its product and, in particular, to the inference that the Turtles, instead of fighting crime from the sewers of the city, in fact broke the law by smoking marijuana.

*Surge Licensing Inc v Pearson*³² —

(4) Action in conjunction with or as an alternative to infringement of copyright.³³ Actionable misrepresentation under sec 52 to restrain a person from claiming proprietorship in an idea, business concept or title can give rights almost as valuable as proprietary rights.³⁴

— *Case example* —

Pop group INXS was involved in merchandise associated with its name. The respondent corporation sold T-shirts under the label “Bootleg T-shirts”, copying almost exactly designs merchandised on behalf of the group. Small signs at the point of sale, and some adhesive labels on the copied T-shirts, stated that designs sold might not be authorised. Interlocutory relief for INXS was granted on the basis that the conduct of the sellers fell within sec 52(1) and also sec 53(c) (¶7-330). It was probable that many rock enthusiasts would have assumed that the merchandise they saw sold at concerts was approved by INXS. If they recognised the material at another location, the same assumption, ie approval in return for financial benefit, would be made. Neither disclaimer was effective.

*MK Hutchence (trading as “INXS”) v South Sea
Bubble Co Pty Ltd*³⁵ —

(5) Action in conjunction with or as an alternative to the tort of defamation.³⁶

32. (1991) ATPR ¶41-119.

33. eg *Computer Edge Pty Ltd v Apple Computer Inc* (1986) 161 CLR 171; (1986) 60 ALJR 313; ¶3-505.

34. *Yardley of London (Australia) Pty Ltd v Chapman & Lester The Sales Promotion Agency Ltd* (1990) ATPR ¶40-989.

35. (1986) ATPR ¶40-667.

36. eg *Giraffe World Pty Ltd v ACCC* (1999) ATPR ¶41-669, ¶7-250 (ACCC press release may be defamatory). Sec 65A limits the operation of sec 52 against the media in relation to newspaper articles or radio or TV broadcasts: ¶8-910; *Nixon v Slater & Gordon* [2000] FCA 531; (2000) Aust Torts Reports ¶81-565.

(6) Action in conjunction with or as an alternative to the enforceability of promises³⁷ and agreements through the law of contract (¶5-010),³⁸ perhaps in part to avoid the limitations of common law actions and equitable remedies and also to take advantage of the court's power to "rewrite" contracts under sec 87 (¶7-850; ¶8-860).³⁹ Section 52 "contract" cases include many claims that could be analysed under traditional rules concerning intention to create legal relations (¶5-050ff), offer and acceptance rules (¶5-130ff) etc, exclusion clause problems (¶7-281) and claims arising under collateral contracts,⁴⁰ promissory estoppel, mistake (¶5-620),⁴¹ privity (¶6-270), and principal and agent (¶11-160).

(7) Action in conjunction with or as an alternative to the tort of negligence (including medical negligence⁴²), manufacturers' liability (¶7-213),⁴³ negligent mis-statement (¶4-295),⁴⁴ and conspiracy⁴⁵ for the reasons mentioned in point (6) above. Section 10 of the *Year 2000 Information Disclosure Act 1999* (Cth)

37. eg *Sykes v Reserve Bank of Australia* (1999) ATPR ¶41-699, (1999) ATPR ¶41-700 (representations as to issue date for polymer bank notes).

38. eg *McWilliam's Wines Pty Ltd v LS Booth Wine Transport Pty Ltd* (1992) 25 NSWLR 723; (1992) ATPR (Digest) ¶46-089 (sec 52 claim for contamination of wine in contract of carriage dismissed); *Lockyer Investment Co Pty Ltd v Smallacombe* (1994) ATPR ¶41-328 (\$326,000 damages for unsuitable irrigation system); *Hurley v McDonald's Australia Ltd* [1999] FCA 1728; (2000) ATPR ¶41-741 (no contractual entitlement to prize in "Monopoly McMatch and Win Competition"); ¶5-060.

39. Hampson, CEK, *Blocked contractual arteries? Try a section 52 by-pass* (1993) 1 TPLJ 22; Harland, D, *The statutory prohibition of misleading or deceptive conduct in Australia and its impact on the law of contract* (1995) 111 LQR 100.

40. *Gates v The City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1; ¶6-030.

41. eg *Lee v Cafred Pty Ltd* (1992) ATPR ¶41-170; ¶5-670.

42. *Vink v Schering Pty Ltd (No 1)* (1991) ATPR ¶41-064; (*No. 2*) (1991) ATPR ¶41-073 (inflammatory disease from intra-uterine device).

43. eg *Hampic Pty Ltd v Adams* [1999] NSWCA 455; (2000) ATPR ¶41-737 (inadequate product labelling).

44. eg *Sweetman v Bradfield Management Services Pty Ltd* (1994) ATPR ¶41-290 (tax adviser not liable under sec 52 because no causal connection between plaintiffs' loss and adviser's misleading conduct; adviser liable for negligence); *Moloney v ANZ Life Assurance Co Ltd* (1997) ATPR ¶41-599 (unsound financial advice to aged pensioners); *Flemington Properties Pty Ltd v Raine & Horne Commercial Pty Ltd* (1999) ATPR ¶41-670 (no evidence of negligent valuation of land); *Kenny & Good Pty Ltd v MGICA* (1992) Ltd (1999) 73 ALJR 901, ¶4-130; ¶4-260.

45. *Australia & New Zealand Banking Group Ltd v Barclays Bank Australia Ltd* (1991) ATPR ¶41-127 (conspiracy to injure by unlawful means, namely, by contraventions of sec 52).

(¶5-015) protects the maker of a disclosure statement about Year 2000 problems, remediation efforts and compliance from potential liability under sec 52.⁴⁶ The AIDS blood transfusion case⁴⁷ discussed at ¶7-206 was also litigated under sec 52 (unsuccessfully).

(8) Action in disputes in many areas of modern business, involving bankruptcy,⁴⁸ partnerships,⁴⁹ companies,⁵⁰ receivers,⁵¹ share issues, share trading,⁵² prospectuses⁵³ and takeovers.⁵⁴

— Case example —

The NRMA “demutualisation” case. The two boards of directors of the two NRMA entities (NRMA Ltd and NRMA Insurance Ltd) resolved to convert the NRMA from companies limited by guarantee (¶9-290) under the mutuality principle into companies limited by shares (¶9-280). Existing NRMA members would become shareholders. Two dissentient directors challenged under sec 52 the prospectus issued for the proposed restructuring, and were successful in gaining an injunction from *Gummow J* under sec 80 (¶8-810): (1) the prospectus failed to set out the potential differences that would affect the members; (2) the use of the term “free shares” was misleading. The shares were not “free” — they were given in exchange for the existing membership, and shareholding would result in members’ loss of certain rights in the companies and certain tax benefits; (3) the statements in the prospectus that it would be “business as usual” for the NRMA after the restructuring failed to specify whether the restructuring would result in higher prices for the NRMA’s services to members. (The fourth challenge failed. There was no shortcoming in the prospectus’ treatment of the taxation and social security aspects of the share issue.) In the words of *Gummow J*, “Partial disclosure of a state of affairs may contravene the section. So also may silence itself, if the circumstances are such as to give rise to a reasonable

46. It also protects the maker from liability under sec 45 (¶8-050), sec 53 (¶7-290), negligent mis-statement (¶4-260) and breach of contract.

47. (1991) 27 FCR 310; (1991) ATPR ¶41-085.

48. eg *Australia & New Zealand Banking Group Ltd v Barclays Bank Australia Ltd* (1991) ATPR ¶41-127.

49. *Hanlon v Brookes* (1996) ATPR ¶41-523, discussed at ¶10-440.

50. eg *Webb Distributors (Aust) Pty Ltd v State of Victoria* (1993) 67 ALJR 961; (1993) ATPR (Digest) ¶46-113 at p 53,516: “Section [563A of the Corporations Law] does not ... preclude an action under sec 52. ...The [TPA] is not to be seen as eliminating, ‘by a side-wind’, the detailed provisions established for more than a hundred years to govern the winding up of a company.”

51. eg *Kinjella Pty Ltd v Jay* (1996) ATPR ¶41-514; ¶13-556.

52. *ASC v Nomura International plc* (1998) ATPR (Digest) ¶46-188.

53. eg *Morey v Transurban City Link Ltd* (1997) ATPR ¶41-571; *Truth About Motorways Pty Ltd v Macquarie Infrastructure Investment Management Ltd* [2000] HCA 11; (2000) ATPR ¶41-757; (2000) 74 ALJR 604 (1996 prospectus on Eastern Distributor Motorway in Sydney).

54. In the corporate area see, eg *Wardley Australia Ltd v The State of Western Australia* (1992) 175 CLR 514 (Rothwells); *Bank of New Zealand v Spedley Securities Ltd (in liq)* (1992) 27 NSWLR 91.

expectation that silence would be broken if particular matters exist. ... directors are bound to exercise their powers in good faith for the benefit of the company as a whole" (¶9-480).

*Fraser v NRMA Holdings Ltd*⁵⁵

As an alternative to Corporations Law sec 588G (the use of which by individuals or companies is extremely restricted) (insolvent trading: ¶9-460), sec 52 can also be used against a company through its directors for misleading or deceptive conduct in incurring debts when it knew or ought to have known that it could not make payment on the due date.⁵⁶ The success of sec 52 led to the passing of the parallel sec 995 in the Corporations Law in 1991, with its own defences which are not available in sec 52 proceedings.⁵⁷

(9) Action in the banking (especially with regard to off-shore loans: ¶16-060), insurance (eg ¶17-560), and financial services sectors, including a disputed bill of exchange and cheque,⁵⁸ again for the reasons mentioned in point (6) above.

(10) Action by consumer groups and public interest groups in support of public causes against misleading or deceptive claims by governments⁵⁹ and advertisers. The passive smoking case (1991: ¶8-810) is a powerful example.

Section 52 has applied to misleading conduct during "without privilege" negotiations.⁶⁰ Its remedies are within the jurisdiction of a commercial arbitrator.⁶¹ It has been applied in breach of fiduciary duty cases, such as in disputes between joint venturers,⁶² and in real property/mortgage/guarantee disputes.⁶³ Action that cannot be brought under sec 52 because of its constitutional limits can instead be brought under the Australia-wide equivalents in all States/Territories (¶7-250).⁶⁴

55. (1994) ATPR ¶41-346 at p 42,530; upheld in later proceedings. Legal proceedings against NRMA's legal advisers for breach of Corporations Law sec 995(2) and the earlier version of sec 728 were unsuccessful: *NRMA Ltd v Morgan* (1999) 17 ACLC 1,029. Later NRMA demutualisation cases include *NRMA Ltd v Yates* (1999) ATPR ¶41-721 and *Yates v Whitlam* (1999) ATPR ¶41-722.

56. *New England Agricultural Traders Pty Ltd v Adams* (1994) ATPR ¶41-361.

57. Section 52 has no defences equal to the "due diligence" defences in Corporations Law sec 731-733.

58. *John Shearer Ltd v Gehl Co* (1996) ATPR ¶41-499, noted (1996) 70 ALJ 528; ¶16-596.

59. eg *Meadow Gem Pty Ltd v ANZ Executors & Trustee Co Ltd* (1994) ATPR (Digest) ¶46-130.

60. *Quad Consulting Pty Ltd v David R Bleakley & Associates Pty Ltd* (1991) 27 FCR 86; (1991) ATPR ¶41-065.

61. *IBM Australia Ltd v National Distribution Services Ltd* (1991) 22 NSWLR 466; (1991) ATPR ¶41-094 ("sec 52" dispute within a wide referral to arbitration; and arbitrator able to give relief beyond damages under TPA sec 87: ¶8-860; ¶1-443).

62. eg *Pacific Coal Pty Ltd v Idemitsu Queensland Pty Ltd* (1992) ATPR (Digest) ¶46-094 (mining joint venture: damages of \$29.5m for breach of contract, fiduciary duty and the TPA).

63. eg *Brueckner v Carroll* (1995) ATPR ¶41-379; ¶13-370.

64. See further Pengilly, W, *Section 52 of the Trade Practices Act: a plaintiff's new Exocet?* (1987) 15 ABLR 247.

¶7-281 Section 52 and exclusion clauses. A person engaging in misleading or deceptive conduct cannot evade the operation of sec 52 by attempting to hide behind an exclusion clause (¶16-180; ¶17-170). If this were possible, the standard of conduct required by sec 52 could be ousted by private agreement.

The very existence of an exclusion clause may add to misleading or deceptive conduct by actively misleading a person about the existence or the scope of the exclusion. For example, sec 52 cases involving contracts for the sale of property containing the standard form disclaimer that “[t]he purchaser acknowledges that he has not relied on any representations by the vendor ...” have declared such disclaimers ineffective against a claim under the *Trade Practices Act*.⁶⁵

Section 52 denies the effectiveness of any agreement made where there is misleading or deceptive conduct, and this includes any outside document such as a “deed of acknowledgement” which intends to excuse a person from liability for misleading or deceptive conduct.⁶⁶

At this stage of the development of sec 52 two arguments are relevant:

- (1) “[I]f the disclaimer has the effect of removing the likelihood of error it removes the capacity of the conduct to mislead or deceive [and thus] it operates not to exclude a liability but to prevent that liability arising”,⁶⁷
- (2) Judicial dicta echoing the statement of Lord Reid in the *Hedley Byrne* case (¶14-240) to the effect that a duty of care does not arise when advice or information is given “with a clear qualification that [the maker] accepted no responsibility for it or that it was given without that reflection or inquiry which a careful answer would require”.⁶⁸

¶7-285 Unconscionable conduct: sec 51AA-51AC. Sections 51AA-51AC⁶⁹ of the *Trade Practices Act* (noted at ¶15-755—¶15-756) prohibits

65. eg *Benlist Pty Ltd v Olivetti Australia Pty Ltd* (1990) ATPR ¶141-043 (real estate agent’s investment report relied on as intended despite its disclaimer: liability under sec 52, 53A).

66. *IOOF Australia Trustees (NSW) Ltd v Tantipecth* (1998) ATPR ¶141-652; ¶17-280.

67. Terry, A, *Disclaimers and deceptive conduct* (1986) 14 ABLR 478 at p 481.

68. *Hedley Byrne & Co Ltd v Heller and Partners Ltd* [1964] AC 465 at p 480 echoed in dicta in *Yorke v Lucas* (1985) 158 CLR 661 at p 666; (1985) ATPR ¶140-622 at p 47,054: “If the circumstances are such as to make it apparent that the corporation is not the source of the information and that it expressly or

impliedly disclaims any belief in its truth or falsity, merely passing it on for what it is worth, we very much doubt that the corporation can properly be said to be itself engaging in conduct that is misleading or deceptive.” Limitation of liability clause not misleading or deceptive and held effective in *Halton Pty Ltd v Steward Bros Drilling Contractors Pty Ltd* (1992) ATPR ¶141-158.

69. Also ASIC Act 1989 (Cth) sec 12CA, 12CB; *Fair Trading Act 1987* (NSW) sec 43; 1999 (Vic) sec 7-8; 1987 (SA) sec 57; 1987 (WA) sec 11; 1989 (Qld) sec 39; 1990 (Tas) sec 15; 1992 (ACT) sec 13; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 43.

unconscionable conduct on a civil basis to give the Act a greater ability to deal with the general disparity of bargaining power between buyers and sellers. It is important to note that factors listed in sec 51AB(2), 51AC(3), (4) are mere indicators of unconscionability, and that their presence or absence will not determine the issue. It is the task of the courts to make this determination in all the circumstances.

¶7-287 Representations as to the future: sec 51A. Section 51A⁷⁰ is an interpretation section designed to widen the operation of the meaning of “misleading” in sec 52 by providing that a representation (including any promissory or predictive pre-contractual statements) about future matters made without reasonable grounds shall be taken to be misleading. The cause of action is that of breach of sec 52.

Section 51A reverses the onus of proof, and requires the person who has made a representation about a future matter to show that the person had reasonable grounds for so doing.

Without sec 51A, the burden would have remained on the plaintiff to show that the representation was within sec 52. Without sec 51A, the plaintiff would have had to show that:

- (1) the conduct or event has not come to pass, and
- (2) when the representation was made, the defendant did not believe that the conduct or event would come to pass or there was no basis for a belief that the conduct or event would come to pass.

Section 52 is moving in the direction of liability for unkept promises.

¶7-290 False representations: provisions of sec 53. In contrast to the widely defined sec 52 with its civil consequences, sec 53 and the equivalent sec 12DB in the ASIC Act 1989 (Cth) give rise to civil and penal consequences. Section 53 is narrowly defined and creates a large number of offences — “probably at least 100 by the time various alternative formulations are counted”.⁷¹

Breach of sec 53 can lead to a fine under sec 79 of up to \$200,000 for companies and \$40,000 for individuals (¶8-790). A person suffering damage as a result of breach of sec 53 may recover civil damages (sec 82: ¶8-840), and injunctions and other orders may be available.

Section 53 targets a “corporation” acting “in trade or commerce, in connection with the supply or possible supply of goods or services”.

70. Also ASIC Act 1989 (Cth) sec 12BB; *Fair Trading Act 1987* (NSW) sec 41; 1999 (Vic) sec 4; 1987 (SA) sec 54; 1987 (WA) sec 9; 1989 (Qld) sec 37; 1990 (Tas) sec 11; 1992 (ACT) sec 11(1); *Consumer*

Affairs and Fair Trading Act 1990 (NT) sec 41(1).

71. *ACCC v Nationwide News Pty Ltd* (1996) ATPR ¶41-519 at p 42,493; ¶7-370.

"Services". Section 4 of the Act defines "services" in a broad but non-exhaustive way to include various rights,⁷² benefits and privileges conferred under contracts such as contracts:

- for work (including professional work);
- for the provision of amusement, entertainment, recreation or instruction;
- for conferring rights under a royalty, etc;
- of insurance;
- of banking;
- for the lending of moneys;⁷³

but the definition does not include benefits arising under a contract of service.

Having regard to the definitions of "supply", "goods" and "services", and the width of the latter words, the net of sec 53 is cast very wide indeed.

¶7-300 False representations as to standard, quality, etc: sec 53(a). Section 53(a)⁷⁴ covers representations of many kinds covering all attributes of the goods in question. Although eight types of representation are indicated, they are in many respects synonymous. It is, however, important to note exactly what each of the representations refers to.

"Standard". A standard is something which serves as a basis of comparison. Thus, an erroneous claim that goods complied with a standard formulated by Standards Australia or prescribed for the purposes of sec 65C (see ¶7-495) would contravene sec 53(a).⁷⁵ Standard may also be similar to the quality or grade of goods or services, so that a representation may breach one or all of the first four attributes of sec 53(a), namely, standard, quality, value or grade.

— Case examples —

In the landmark *Sharp case*, advertisements claimed that all microwave ovens in question were tested and approved by the Standards Association of Australia. The claims made were found to be "completely and utterly false". In making this finding *Joske J* observed that not only was every Sharp microwave oven not fully tested and approved as the advertisement said, but the Standards Association of Australia had never tested or approved any one of the ovens.

72. Including rights in relation to personal property such as the grant of a copyright licence: *Trumpet Software Pty Ltd v OzEmail Pty Ltd* (1996) ATPR ¶41-511 (¶3-505, ¶7-280).

73. eg *Westpac Banking Corporation Ltd v Prelea* (1992) 28 NSWLR 481; (1992) ATPR (Digest) ¶46-093; ¶7-012.

74. Also *Fair Trading Act 1999* (Vic) sec 12(a); 1987 (NSW) sec 44(a); 1987 (SA) sec 58(a);

1987 (WA) sec 12(1)(a); 1989 (Qld) sec 40(a); 1990 (Tas) sec 16(a); 1992 (ACT) sec 14(a); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(a).

75. eg *O'Bryen v Coles Myer Ltd* (1993) ATPR ¶41-209 (nightdresses mislabelled for fire safety: fine of \$52,000 imposed for five breaches of sec 53(a) and five breaches of sec 65C(1)(a)).

In addition to the above-quoted claims, brochures published by the defendant also contained a facsimile of the registered trade mark of the Standards Association of Australia (now Standards Australia) together with the words “approved to Australian standards certificate numbers” and certain numbers. This was said by *Joske J* to be “an extraordinarily wrong misrepresentation, a wicked misuse of the trade mark”.

_____ *Hartnell v Sharp Corporation of Australia Pty Ltd*⁷⁶ _____

An order for about 10,000 toy koalas and toy kangaroos was supplied by the defendant toy importer and distributor to Woolworths. The toys were labelled “Made in Australia” and claimed certain compliances and the “Advance Australia” sponsorship. In fact these representations were false and the toys were made in Korea. After its initial technical defences failed, the importer was fined a total of \$31,500 under:

- sec 53(a) “standard” — for the false representation in the label reading “this item exceeds all Australian Safety Regulations including the Inflammability Act”: no such Act exists;
- sec 53(a) “history” — for the false representation that the toys were made in Australia (now actionable under sec 53(eb): ¶7-356);
- sec 53(c) “sponsorship” (the “Advance Australia” logo) — for the false representation that the toys had the sponsorship of the Advance Australia company.

An argument that the toy distributor could not be vicariously liable for the conduct of Woolworths in offering the toys for sale, as Woolworths was not its agent, was rejected. Even though contractual relations existed only between the toy distributor and Woolworths, the court accepted that representations under sec 53 were made by the toy distributor (even if made concurrently to and by Woolworths) when made to prospective retail purchasers.

_____ *Barton v Croner Trading Co Pty Ltd*⁷⁷ _____

“*Quality*”. The notion of “quality” refers to further attributes of the goods in question. A claim that the goods have unique or exclusive qualities which they do not have, such as “exclusive two-way action” when all competing products have the same quality, would provide one example. Or an advertisement which fails to disclose the true quality of goods (teak veneer as “teak”, silver plate as “silver”) must state any necessary qualification.

— *Case example* —

A statement as to the number of kilometres travelled by a particular car (23,700 instead of the 69,000 actually travelled) was held to describe a particular attribute or feature of the car and therefore describe a “particular quality” of that car.

_____ *Given v CV Holland (Holdings) Pty Ltd*⁷⁸ _____

76. (1975) ATPR ¶40-003; (1975) 5 ALR 493; extracted further at ¶8-790.

77. (1984) 3 FCR 95; (1985) ATPR ¶40-525; similarly *Siddons Pty Ltd v The Stanley*

Works Pty Ltd (1991) 29 FCR 14; (1991) ATPR ¶41-111 (neither company’s hand tools fully made in Australia).

78. (1977) 29 FLR 212; (1977) ATPR ¶40-029.

“Value”. From 1988, false representations as to the *value* of goods (or services (sec 53(aa) ¶7-310)) are added to the Act in response to *Chaudhary’s case* — where a false representation that goods had a “value” of almost ten times the approximate market price was held to be not in itself a representation of a particular “standard” or “quality”.⁷⁹

“Grade”. This expression can be used as a synonym for “standard” or “quality”, or it can refer to an identifiable and objectively administered scheme of classification.

“Composition”. This word catches deceptive labelling, where the label and the actual composition of the goods do not tally.

— *Case example* —

A wine manufacturing company was fined \$165,000 and its two directors were fined \$10,000 each (¶8-790) for false representations that its wine was of a particular composition (that it was of a certain vintage and of a certain type). These high fines reflected the fact that the offences could not be detected by the human senses or by technology, and that in the matter of wine blending and components the public is wholly dependent on the integrity of the winemaker.

*TPC v The Vales Wine Company Pty Ltd*⁸⁰ —

“Style” or “model”. “Style” covers another aspect of “quality” or “grade”. Additionally, it could cover a type — eg of biscuit, such as low kilojoule. “Model” has an everyday use in reference to consumer goods — 2000 model, etc — and a false representation would be clearly made where a car was represented as the latest model, or a 2001 model, when in fact it was the model of the previous year.

— *Case example* —

A full page Nissan advertisement in *The Advertiser* newspaper in Adelaide headed “Nissans [sic] 30th Anniversary Sale Continues ...” included a Nissan Patrol RX 2.8 Turbo Diesel. The advertisement was illustrated with a picture of the wrong vehicle, a Patrol RX 4.2 — a more expensive model with over fender flares and wider wheels than the RX 2.8. For this mistake, Nissan was convicted and fined \$30,000 for breach of sec 53(a).

The advertisement was repeated eight times a few weeks later, with the disclaimer “Pic. for illustration purposes only”. Nissan was convicted and fined \$50,000 for breach of sec 53(a) for this second campaign. The marketing director of Nissan’s advertising agency was also convicted and fined \$10,000 personally. Such a disclaimer was held not to “cover us legally”, as the marketing director believed. In addition, Nissan gave enforceable undertakings

79. *Ducret v Chaudhary’s Oriental Carpet Palace Pty Ltd* (1987) 16 FCR 562; (1987) ATPR ¶40-804.

80. (1996) ATPR ¶41-480; *ACCC v The Vales Wine Company Pty Ltd* (1996) ATPR ¶41-528, noted in *ACCC Journal*,

Issue 7, pp 3, 26 (February 1997). See also, eg, *TPC v Pacific Dunlop Ltd* (1994) ATPR ¶41-307 (“Red Robin” socks falsely labelled pure cotton: fine of \$25,000. Also fine of \$10,000 for false labelling of socks as “made in Australia” in breach of sec 53(eb): ¶7-356).

under sec 87B (¶8-866) to make an ex gratia payment of \$2,000 to each of the 17 purchasers of the model in question.

_____ *ACCC v Nissan Motor Company (Australia) Pty Ltd*⁸¹—

“A particular history”. These words are specifically aimed at situations where, for example, odometers are wound back to show a lower reading. In addition to catching the word “quality”, the expression “a particular history” would catch a false representation such as “only one owner”, “ex-GMH” or “Made in Australia”.⁸²

“Particular previous use”. “Only one owner” or “ex-GMH” would be caught by these words as would the wound-back odometer. Any false representation relating to second hand goods would certainly not get through the “particular previous use” net, even if it managed to escape the “standard” or “quality” test.

¶7-310 False representations in relation to services: sec 53(aa).¹ This paragraph uses the same words “standard, quality, value or grade” as sec 53(a). They are discussed above in ¶7-300. But they relate to services, and this expression in the *Trade Practices Act* is important. The Sale of Goods Acts generally do not read implied conditions on fitness, merchantability, etc into contracts for supply or installation, etc, and this area had been left to the common law.

The scope of sec 53(aa), read with the extended definition of services, means that an aggrieved insured person, or traveller, or bank customer, or finance company debtor could sue under sec 53(aa) for a false representation as to standard, quality, value or grade of the services offered.

— *Case example* —

Promoters posted unsolicited material to various businesses in Australia inferring a compulsion to pay a “registration fee” to be included in their Register or Guide. The documents referred to the “Department of Australian Business and Companies Register”, with an alleged government connection. This particular conduct was held to be in breach of sec 53(aa) as the promoters were not providing “Government services” and therefore the services were not of the represented “standard” or “quality”.

_____ *ACCC v Optell Pty Ltd*² —

81. (1998) ATPR ¶41-660, noted ACCC Journal, Issue 18, p 37 (December 1998); Issue 20, p 25 (April 1999). Nissan was also convicted and fined for breach of sec 53(e): ¶7-350.

82. *Barton v Croner Trading Pty Ltd* (1984) 3 FCR 95; (1985) ATPR ¶40-525; *Korczynski v Wes Lofts (Aust) Pty Ltd* (1986) ATPR ¶40-643.

1. Also ASIC Act 1989 (Cth) sec 12DB(a); *Fair Trading Act* 1987 (NSW) sec 44(b); 1999 (Vic) sec 12(b); 1987 (SA) sec 58(b); 1987 (WA) sec 12(1)(b); 1989 (Qld) sec 40(b); 1990 (Tas) sec 16(b); 1992 (ACT) sec 14(b); *Consumer Affairs and Fair Trading Act* 1990 (NT) sec 44(b).

2. (1998) ATPR ¶41-640.

At the same time, the Act implies certain warranties of due care and skill and fitness for purpose into consumer transactions for the supply of services (including professional services) except services excluded in sec 74(3) (transportation or storage of goods for a business customer; insurance: ¶7-095; ¶17-500).

¶7-320 False representations that goods are new: sec 53(b).³ The ACCC has stated that the word “new” is a word to “handle with care”. In the view of the ACCC, new means “not used or repaired or reconditioned, or used in display, and also not old or already known.”⁴

The former TPC had summarised the words of the court in the *ABE Copiers case*⁵ as follows:⁶

- “— ‘New’ does not have a fixed and inflexible meaning;
- The meaning is a question of fact in each case;
- Depending on the context in which the word appears, it may mean ‘not secondhand’, ‘not old’, ‘of recent origin’ or ‘not excessively used’;
- For goods to be new they do not have to be in ‘mint condition’ and the mere fact that goods are damaged, irrespective of the nature or quality of any repairs, does not mean that they have ceased to be new;
- In some cases an article may cease to be new even if it is used for a comparatively short period.”

¶7-325 False representations that goods or services have been ordered: sec 53(bb). Section 53(bb),⁷ added in 1986, prohibits false representations that goods or services have been ordered when they have not, and is directed at such practices as the assertion of a right to payment for goods or services allegedly ordered by a recently deceased person.

3. Also *Fair Trading Act 1987* (NSW) sec 44(c); 1999 (Vic) sec 12(c); 1987 (SA) sec 58(c); 1987 (WA) sec 12(1)(c); 1989 (Qld) sec 40(c); 1990 (Tas) sec 16(c); 1992 (ACT) sec 14(c); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(c).

4. See ACCC, *Advertising and Selling*, AGPS, 1997, pp 33, 36.

5. *Hollis v ABE Copiers Pty Ltd* (1979) 41 FLR 141; (1979) ATPR ¶40-115.

6. TPC, *Advertising and Selling*, AGPS, 2nd ed, 1991, pp 34-35 (now superseded).

7. Also ASIC Act 1989 (Cth) sec 12DB(b); *Fair Trading Act 1987* (NSW) sec 44(d); 1999 (Vic) sec 12(d); 1987 (SA) sec 58(d); 1987 (WA) sec 12(1)(d); 1989 (Qld) sec 40(d); 1990 (Tas) sec 16(d); 1992 (ACT) sec 14(d); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(d).

¶7-330 Representations as to characteristics, uses, etc of goods and services: sec 53(c). Section 53(c)⁸ prohibits representations “that goods or services have sponsorship, approval, performance characteristics, accessories, uses or benefits they do not have”. Each representation is an independent offence, and only one contravention need be proved.

“*Sponsorship*” or “*approval*”. Any claims of sponsorship or approval must be accurate regarding existence and extent. If goods are stated to have been tested, and if the advertisement says that “every” article is tested, the advertisement must be literally true and every article must have been individually subjected to the stated test. In the landmark *Sharp* microwave oven case, the company was prosecuted by the then TPC for a breach of sec 53(a) (¶7-300) and sec 53(c).⁹

Representations that goods or services have been approved by a person¹⁰ or by an independent organisation (in the sense of certified as to quality or accuracy), when they have not been so approved, are caught by the section. “Sponsorship” or “approval” requires some active step; merely to use a logo similar to that in use by another business may not of itself constitute the necessary representation of sec 53(c) unless there is an implied representation of association between products.¹¹

Indorsements fall within two categories. The first amounts to the use of prominent personalities to attract attention, and where such personalities merely express a personal opinion it is unlikely that representations of the kind with which the law is concerned will be made. Statements made should, however, be capable of substantiation. Where persons who are known to be experts in a particular field make statements of fact and opinion drawing on their experience, these must be capable of substantiation. Indorsements claiming to be unsolicited should not have been solicited in any way.

“*Performance characteristics*”. This covers “the way in which something reacts under certain conditions or fulfils the purpose for which it was

8. Also ASIC Act 1989 (Cth) sec 12DB(c); *Fair Trading Act 1987* (NSW) sec 44(e); 1999 (Vic) sec 12(e); 1987 (SA) sec 58(e); 1987 (WA) sec 12(1)(e); 1989 (Qld) sec 40(e); 1990 (Tas) sec 16(e); 1992 (ACT) sec 14(e) *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(e).

9. *Hartnell v Sharp Corporation of Australia Pty Ltd* (1975) ATPR ¶40-003; ¶7-300

10. eg Tracey Wickham Pools not approved by former swimming champion Tracey Wickham: *Wickham v Associated Pool Builders Pty Ltd* (1988) ATPR ¶40-910, noted (1989) 63 ALJ 281.

11. McCain’s use of the name “Healthy Choice” and similar packaging in relation

to frozen dinners was not a representation of association with the US company ConAgra’s “Healthy Choice” product as the latter had no significant reputation in Australia: *ConAgra Inc v McCain Foods (Aust) Pty Ltd* (1992) 33 FCR 302; (1992) ATPR (Digest) ¶46-095 (Full Federal Court). Unauthorised use of Sydney Olympics words and symbols (“ambush marketing”) breaches sec 52 (¶7-280), 53(c) and 53(d) (¶7-340) and is specifically prohibited by the *Sydney 2000 Games (Indicia and Images) Protection Act 1996* (Cth); ¶12-020.

intended",¹² and applies to a wide range of claims. Durability, speed, "fully automatic", profit projections from trading in futures contracts,¹³ and arguably a representation on the safety of goods, are examples of claims made on performance characteristics.

"Accessories". To claim that a product has accessories it does not have will contravene sec 53(c). Likewise, to advertise that accessories are included in the price of goods when they are "extra" will also be caught by sec 53(c).

"Uses". For example, the promotion of the sale and installation of home cladding in an area where the climatic conditions would severely affect its durability is one which would fall within this area. The item either works — "fit for its use" — or it does not.

"Benefit". In the same way, the word "benefit" overlaps the other forms of false representation of sec 53(a) and 53(c). Benefit suggests an advantage or something positive. Where an advertiser inflates and exaggerates the features of the item ("maintenance free"), there is a danger of breaching sec 53(c).

¶7-340 Representations as to sponsorship, etc: sec 53(d).¹⁴

These areas of representation are the same as two of those relating to goods under sec 53(c), namely, "sponsorship" or "approval" (see ¶7-330), but one new word appears, "affiliation". Instead of the paragraph being concerned with representations about goods, it is aimed at untrue representations about the business structure itself. Representations that the business is an offshoot of or affiliated with a well known organisation, such as the Sydney Olympics, would be actionable if it were not so affiliated.¹⁵ Case law suggests that sec 53(d) requires a positive representation of affiliation by a positive link such as the use of the "Lego" trade mark on the packaging and advertising of a competitor's toy blocks incorrectly suggesting Lego's approval or indorsement of the competitor.¹⁶

12. Definition of "performance" in the *Macquarie Dictionary*, quoted in *Glendale Chemical Products Pty Ltd v ACCC* (1999) ATPR ¶41-672 (implied representation that it was safe to use dry caustic soda in hot water to unblock a drain); ¶7-215.

13. *Dillon v Chin* (1988) ATPR ¶40-899.

14. Also ASIC Act 1989 (Cth) sec 12DB(d); *Fair Trading Act 1987* (NSW) sec 44(f); 1999 (Vic) sec 12(f); 1987 (SA) sec 58(f); 1987 (WA) sec 12(1)(f); 1989 (Qld)

sec 40(f); 1990 (Tas) sec 16(f); 1992 (ACT) sec 14(f); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(f).

15. eg *Paragon Shoes Pty Ltd v Paragini Distributors (NSW) Pty Ltd* (1988) ATPR ¶40-919; similarly *Sydney Olympics "ambush marketing"*: ¶7-280, ¶7-330.

16. *Interlego AG v Croner Trading Pty Ltd* (1993) ATPR (Digest) ¶46-098; leave to appeal to High Court refused (1993) 68 ALJR 123.

¶7-350 False representations as to price: sec 53(e). Section 53(e)¹⁷ prohibits false or misleading representations concerning price, including price reductions and ancillary matters such as where, when and how to obtain the benefit of the reduction or the reason for the reduction. "Price" is defined in sec 4(1) to include "a charge of any description".

— *Case example* —

Nissan TV advertisements, screened about 30 times for four weeks, which promoted end of year savings and claimed that consumers would "save a whopping \$6,290 ... including free airconditioning", were false. The model had retailed at that price before the advertisements, and the only saving was \$2,200 for free airconditioning. Nissan was convicted for breach of sec 53(e), and fined \$50,000.

— *ACCC v Nissan Motor Company (Australia) Pty Ltd*¹⁸ —

Various categories of representation may fall within the ambit of sec 53(e), such as:

"Price comparison claims". Comparison with competitors' prices, comparison with the normal selling price and comparison with a recommended retail price all come under this heading. The overall effect of the advertisement must be considered in any assessment of a possible breach. It would be accurate to claim that any advertised price will be reduced by a set amount if that was the advertiser's genuine intention. Although claims regarding discounts or lower prices are often mere advertising "puffs" or self-expressed opinion of a company's pricing policy, specific claims should be capable of substantiation. Material differences between goods which are compared should be disclosed.

Comparisons with the advertiser's normal selling price should relate to the price at which goods are sold over a reasonable period. The normal selling price can be determined by reference to matters such as the market, the advertising and the frequency of price changes.

Comparisons with a recommended retail price may be misleading if this price is never charged by the advertiser or its competitors.

"Price reduction claims". The scope for deception is increased where no reference to the normal price is made. Representations within this area must not relate to illusory reductions,¹⁹ and advertisers should ensure that the benefits of claimed reductions are actually available to purchasers.

17. Also ASIC Act 1989 (Cth) sec 12DB(e); *Fair Trading Act 1987* (NSW) sec 44(g); 1999 (Vic) sec 12(g); 1987 (SA) sec 58(g); 1987 (WA) sec 12(1)(g); 1989 (Qld) sec 40(g); 1990 (Tas) sec 16(g); 1992 (ACT) sec 14(g); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(g).

18. (1998) ATPR ¶41-660. Nissan and its advertising agent were also convicted and fined for breaches of sec 53(a): ¶7-300.

19. eg *TPC v Cue Design Pty Ltd* (1996) ATPR ¶41-475.

“Undisclosed charges and inclusive prices”. Any additional charges such as delivery or installation charges should be stated clearly when reference is made to price. Accessories depicted in advertising should be included in a specified price unless reference is made to their additional cost.

“Price ranges”. Representations that goods are available “from” a certain price must be representative of the true range available, and qualifications such as “most around \$x” will ensure that the advertisement in question is sufficiently informative.

— *Case example* —

Advance Bank published five advertisements for “Home loan protection for \$2 a week” based on a mortgage of \$60,250. The advertisements promised home mortgage insurance cover against (1) unemployment and (2) sickness or disability for in total \$104 a year. The advertisements breached sec 53(e), and Advance was fined \$4,000 because they made false representations about the price of the insurance cover, which covered only unemployment but not sickness or disability unrelated to unemployment as advertised. For example, one consumer was quoted \$301 for sickness and disability cover, not the \$104 a year as advertised.

— *TPC v Advance Bank Australia Ltd*²⁰ —

¶7-353 False representations as to facilities for repair or spare parts: sec 53(ea). Section 53(ea),²¹ added in 1986, prohibits false or misleading representations about the availability of facilities for repair or spare parts, and is especially designed to provide additional protection to persons such as farmers and truck owner-operators who had formerly sometimes experienced difficulty in obtaining repairs or spares for their expensive machinery contrary to promises made at the time of purchase.

¶7-356 False representations as to origin of goods: sec 53(eb). Added in 1986, sec 53(eb)²² renders actionable a false or misleading statement concerning the place of origin of goods, and applies to false “made in Australia” cases (see ¶7-300).

— *Case examples* —

A manufacturer labelled air conditioners as “Made in Australia”. The ACCC failed in a prosecution under sec 53(eb) when the court held that the air conditioners were substantially manufactured in Australia: they were wholly designed in Australia, wholly assembled in Australia and all components were made in Australia except the compressor.

— *ACCC v Lovelock Luke Pty Ltd*²³ —

20. (1993) ATPR ¶41-229.

21. *Fair Trading Act 1987* (NSW) sec 44(h); 1999 (Vic) sec 12(h); 1987 (SA) sec 58(h); 1987 (WA) sec 12(1)(b); 1989 (Qld) sec 40(h); 1990 (Tas) sec 16(h); 1992 (ACT) sec 14(h); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(h).

22. Equivalent in other jurisdictions: *Fair Trading Act 1987* (NSW) sec 44(i); 1999 (Vic) sec 12(i); 1987 (SA) sec 58(i); 1987 (WA) sec 12(1)(j); 1989 (Qld) sec 40(i); 1990 (Tas) sec 16(i); 1992 (ACT) sec 14(i); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(j).

23. (1997) ATPR ¶41-594.

Some John West tuna products were labelled “Made in Australia” or equivalent even though they sometimes included imported tuna. As corrections had been made by John West, and an offending TV advertisement had been withdrawn, no penalty was imposed for breach of sec 53(eb) beyond an injunction restraining John West from publishing any statement breaching the section.

————— *ACCC v Unilever Australia Ltd*²⁴ ———

Division 1AA (sec 65AA-65AN) of Part V, added to the Act in 1998,²⁵ gives a corporation a defence for action under sec 52 and 53(eb) for certain country of origin representations such as “Made in Australia”:

- sec 65AB provides a defence if:
 - the goods have been “substantially transformed in” that country, defined in sec 65AE to mean to “undergo a fundamental change ... in form, appearance or nature”, and
 - if “50% or more of the cost of producing or manufacturing the goods” is attributable to that country.
- sec 65AC provides that terms such as “Made in Australia” (or other country) are restricted to goods in which “all, or virtually all, processes involved in the production or manufacture happened in that country”.
- sec 65AD provides that country of origin logos may be specified in the *Trade Practices Regulations* if the goods have been “substantially transformed” in the country represented by the logo and 51% or more of the cost of producing or manufacturing the goods is attributable to that country.

In addition, “Made in Australia” is permitted by the Department of Trade, the Australian Trade Commission and Austrade if 50% of manufacturing costs are incurred in Australia.

The “Australian Made” logo of the Advance Australia Foundation is permitted if at least 75% of the cost of producing the product is incurred in Australia, and if the major parts are of Australian origin and the operations which give the product its essential qualities and character take place in Australia.

¶7-360 False representations as to need: sec 53(f).²⁶ As consumers in the modern technological world, how do we know whether the washing machine needs the work advised by the service agent? How do we know whether the house needs spraying for pest control? How do we

24. (1998) ATPR ¶41-607, noted ACCC Journal, Issue 13, p 36 (February 1998).

25. By the *Trade Practices Amendment (Country of Origin Representations) Act 1998* (Cth), which commenced on 13 August 1998.

26. Also ASIC Act 1989 (Cth) sec 12DB(f); *Fair Trading Act 1987* (NSW) sec 44(j); 1999 (Vic) sec 12(j); 1987 (SA) sec 58(j); 1987 (WA) sec 12(1)(k); 1989 (Qld) sec 40(j); 1990 (Tas) sec 16(j); 1992 (ACT) sec 14(j); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 44(k).

know whether the car needs the work recommended? False representations as to the need for services are caught by sec 53(f).

False claims that goods or services are necessary to comply with local government regulations or that optional extras are necessary for goods to function properly would fall within the section. Particular attention should be paid to claims by experts that a particular product is necessary.²⁷

¶7-370 False representations as to condition, warranty, etc: sec 53(g). Section 53(g)²⁸ prohibits the making of a “false or misleading representation concerning the existence, exclusion or effect of any condition, warranty, guarantee, right or remedy.” This is one of the most important provisions in the *Trade Practices Act* and, as with sec 52 and the other provisions of sec 53, it provides an effective alternative to action for breach of contract (¶5-010, ¶7-280) in disputes concerning conditions and warranties (¶6-050) and rights and remedies. For example:

- a false or misleading statement given by an insurer regarding the cover provided by the policy is a contravention of sec 53(g), as it concerns the existence of a right (the cover) arising under the policy.²⁹
- advertising “free mobile phones” in newspapers, on radio and on TV, with the words “Conditions apply”, infringing sec 53(g) because it involved false representations of the effect of the conditions (a 15-month subscription which was not “free”) and resulted in penalties of \$120,000 under sec 79.³⁰

Section 53(g) applies to conditions, etc whether express (¶6-050) or implied by statute (¶7-035). It especially gives effect to the non-excludable implied conditions contained in consumer contracts (¶7-170). Persons drafting “warranties” (not to be confused with contractual “warranties”: ¶6-050) and warranty cards should therefore be particularly careful not to exclude or reduce these implied conditions. In the words of the ACCC:³¹

“If one of the statutory warranties is breached, the consumer may have a variety of remedies. These include repair or replacement of the goods, or resupply of the services, or payment for these things to be done. In the broader sense the consumer has the right to compensation for any loss or damage suffered as a consequence of the breach of a statutory warranty. The appropriate remedy for a given case will depend on the particular circumstances involved. One important circumstance may be the time that has passed since

27. *Keehn v Medical Benefits Fund of Australia Ltd* (1977) ATPR ¶40-047.

28. Also ASIC Act 1989 (Cth) sec 12DB(g); *Fair Trading Act* 1987 (NSW) sec 44(k); 1999 (Vic) sec 12(k); 1987 (SA) sec 58(k); 1987 (WA) sec 12(1)(l); 1989 (Qld) sec 40(k); 1990 (Tas) sec 16(k); 1992 (ACT) sec 14(k); *Consumer Affairs and Fair Trading Act* 1990 (NT) sec 44(m).

29. eg *TPC v Clarke Eaton and Co Pty Ltd* (1993) ATPR ¶41-233 (insurance broker fined \$10,000 for breaches of sec 53(g)).

30. *ACCC v Nationwide News Pty Ltd* (1996) ATPR ¶41-519; appeal dismissed (1997) ATPR ¶41-543.

31. ACCC, *Advertising and Selling*, 2nd ed, 1991, *op cit*, pp 31-32.

purchase; when goods are relatively new, the customer can probably insist on replacement; if goods are older, repair rather than replacement may be the more appropriate remedy.

One remedy which may apply is return of the goods and a refund of the purchase price. Where statutory warranties are involved, the right to a refund is an important one and cannot be improperly limited or excluded by sellers. Sellers cannot say 'No refunds', but can use signs which clearly inform consumers about certain permitted limits on refunds. Broadly speaking, consumers too have responsibilities concerning refunds."

— *Case example* —

After a complaint regarding a national clothing chain from a consumer who had been refused a refund for a pair of slacks damaged by being washed according to the attached care instructions, the TPC's investigations found several examples of offences under sec 53(a) (¶7-300), sec 53(g), and sec 65D(1) (¶7-495). Many garments had wrong fibre composition labels and missing or wrong care instruction labels. In particular, stores displayed "no refunds" signs, and had sales dockets which stated "We do not give refunds". These signs or dockets gave a false representation to the consumer, as they suggested that goods could not be returned even if unmerchantable or unfit for their purpose. The TPC's prosecution was successful, and the chain was fined \$15,000 for breaches of sec 53(a), 53(g) and 65D(1).

TPC v Fiona's Clothes Horse Pty Ltd³² —

As well as being prohibited under sec 53(g), clauses that attempt to exclude the provisions of Part V Div 2 are void under sec 68 (¶7-210).

— *Case example* —

P entered into hire-purchase agreements with D relating to a second hand prime mover and trailer. A document summarising P's financial obligations and signed by him included a clause which in part read "I hereby acknowledge that the statement that the goods are second hand and that such conditions and warranties are expressly negated has been brought to my notice". D's hire-purchase offer, also signed by P, included a clause (cl 8) which stated that:

"... all conditions and warranties as to quality and all conditions and warranties as to fitness and suitability are expressly negated to the maximum extent that the law allows. So far as the law permits all other conditions and warranties which might be implied are also negated and excluded..."

The High Court held in favour of P that cl 8, by which D sought to exclude the condition as to fitness implied by sec 5(3) of the (since repealed) *Hire-Purchase Act 1960* (NSW),³³ did not unequivocally expressly and unqualifiedly negative the implied condition of fitness as was required by sec 5(3), cl 8 being qualified by the words "to the maximum extent that the law allows."

32. (1989) ATPR ¶40-963.

33. *Hire-Purchase Act 1959* (Qld) sec 5(3); 1959 (WA) sec 5(3); 1959 (Tas) sec 9(3).

In particular, the court noted that the clause in the hire-purchase offer had been drafted to accommodate the operation of the non-excludable implied conditions in sec 71 and 72 (¶7-035) and that:³⁴

“[a]ny unqualified statement that all conditions and warranties of quality, fitness and suitability were negatived might have amounted to misleading or deceptive conduct on the part of Esanda or a false or misleading statement concerning the exclusion of a condition in the case of transactions in which the *Trade Practices Act* conditions were implied (*Trade Practices Act* sec 52(1) and 53(g)).”

However, because of the narrow definition of “consumer” (¶7-012), this transaction was not a “consumer” sale and these TPA implied conditions did not operate.

— *Esanda Ltd v Clark*³⁵ —

¶7-380 False representations in relation to land: sec 53A.

Section 53A³⁶ prohibits certain misleading representations and conduct in relation to the sale of land,³⁷ including sale of a house or land by auction.³⁸ For example, representations such as “building block”, “ocean views”, or with respect to zoning or the availability of services would be caught under sec 53A(1)(b).³⁹ But the section does not supplement State real property law, and should not interfere with defects in title, etc discoverable in the normal conveyancing process (¶3-450).

¶7-390 Misleading conduct in relation to employment: sec 53B.

Section 53B of the *Trade Practices Act* prohibits a corporation from engaging in misleading conduct in relation to employment before a contract of employment arises. Conduct which is liable to mislead those seeking employment in relation to availability, nature, terms or conditions, or any other matter relating to the employment will be caught by the section.⁴⁰

34. At p 548; pp 47,359-47,360.

35. (1985) 159 CLR 543; (1986) ATPR ¶40-665; noted (1986) 60 ALJ 353.

36. Also ASIC Act 1989 (Cth) sec 12DC; *Fair Trading Act* 1987 (NSW) sec 45; 1987 (SA) sec 59; 1987 (WA) sec 12(2); 1989 (Qld) sec 40A (added 1994); 1990 (Tas) sec 17; 1992 (ACT) sec 15; *Consumer Affairs and Fair Trading Act* 1990 (NT) sec 45.

37. The “prescribed publication of matter by a prescribed information provider” is removed from the operation of sec 53A by sec 65A (see ¶8-910).

38. eg *Garvey v Vamamu Pty Ltd (t/a Raine & Horne Woollahra)* (1998) ATPR ¶41-656.

39. eg “Blue Ribbon Investment Seaside Cottage \$9,900” — in fact, an uninhabitable tin shed — fines under sec 79, for breaches of sec 53A and sec 56 (¶7-420) on the corporation of \$180,000 and its director \$21,000: *Guthrie v Robertson* (1987) 13 FCR 336; (1986) ATPR ¶40-744; implied representation that building suitable for strata title subdivision: *Benlist Pty Ltd v Olivetti Australia Pty Ltd* (1990) ATPR ¶41-043.

40. See also *Fair Trading Act* 1987 (NSW) sec 46; 1999 (Vic) sec 13; 1987 (SA) sec 60; 1987 (WA) sec 14; 1989 (Qld) sec 41; 1990 (Tas) sec 18; 1992 (ACT) sec 16; *Consumer Affairs and Fair Trading Act* 1990 (NT) sec 46.

The types of situation envisaged by the section include:

- advertising vacant positions which do not exist or which are already subject to a pre-existing recruitment arrangement with the prospective employer;
- employment advertising which is used as a means of promoting other enterprises such as self-improvement courses and photographic studios with little benefit to the job seeker.

The Commission now requires that any claims made by agencies on the marketability of self-improvement courses, etc be capable of substantiation.

— *Case example* —

A real estate agent, wishing to employ several people as real estate salespersons and marketers, advertised in the local paper under “Help Wanted” for a variety of positions — such as for electricians and plumbers — to “start work on a big project”. Several people applied for employment only to discover its true nature to be real estate. The real estate agent was convicted of an offence under the *Fair Trading Act 1989* (Qld) equivalent of sec 53B and, in view of having had no previous convictions, the agent was fined \$2,000 (out of a maximum penalty in Queensland of \$24,000).

— *Dever v Creevey; Ex parte Creevey*⁴¹ —

The Commission reported in 1994 that the number of dubious job advertisements had fallen from 10% in 1992 to 6% in 1993, and that many of these advertisements had moved from the metropolitan dailies to suburban newspapers.⁴²

¶7-395 Cash price to be stated: sec 53C. Section 53C,⁴³ added in 1986, prohibits a corporation from advertising part only of the consideration payable for goods or services without disclosing the total consideration for outright purchase, and, for example, prevents a car dealer from advertising the deposit payable and/or the periodic payments on the purchase of a vehicle without mentioning the cash price.⁴⁴

41. (1991) ATPR (Digest) ¶46-079 (Full Court, Supreme Court of Queensland). Similarly, *Holloway v Gilport Pty Ltd*; *Holloway v Zygaldo* (1995) ATPR ¶41-408.

42. Trade Practices Commission, Media Council of Australia and JobWatch, *Misleading job ads — how to handle them*, 1994.

43. See also ASIC Act 1989 (Cth) sec 12DD; *Fair Trading Act 1987* (NSW) sec 47; 1999 (Vic) sec 15; (SA) sec 61; (WA) sec 15; 1989 (Qld) sec 42; 1990 (Tas) sec 21A; 1992 (ACT) sec 17; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 50.

44. *TPC v Autoways Pty Ltd* (1990) ATPR ¶41-051.

OTHER UNFAIR PRACTICES — TRADE PRACTICES ACT SEC 54-65

Offering gifts and prizes: sec 54	¶7-400
Misleading conduct to which the Industrial Property Convention applies: sec 55	¶7-410
Misleading conduct regarding services: sec 55A	¶7-415
Bait advertising: sec 56	¶7-420
Referral selling: sec 57	¶7-430
Accepting payment without intending to supply as ordered: sec 58	¶7-440
Misleading representations about certain business activities: sec 59	¶7-450
Door-to-door sales harassment and coercion: sec 60	¶7-460
Pyramid selling: sec 61	¶7-470
Inertia selling: sec 63A, 64, 65	¶7-490
Product safety and product information: sec 65B-65R	¶7-495

¶7-400 Offering gifts and prizes: sec 54.¹ The conduct prohibited by this section is the offering of gifts, prizes or other free items with a hidden catch.² So long as there is an intention not to provide the items at all, “or of not providing them as offered”, the section will be breached.

Proof of intention is essential to proof of breach of sec 54. The requisite intention is that of not providing the goods or of not providing them as offered.

The TPC (now the ACCC) has stated³ that where there is no intention to supply the goods at all the position is fairly clear; however, where the intention is to supply other than as offered, the TPC states that prohibited conduct would include:

“— offers which do not adequately inform persons of the applicable terms, conditions or limitations, eg if persons responding to advertisements

1. Also ASIC Act 1989 (Cth) sec 12DE; *Fair Trading Act 1987* (NSW) sec 48; 1999 (Vic) sec 16; 1987 (SA) sec 62; 1987 (WA) sec 16; 1989 (Qld) sec 43; 1990 (Tas) sec 19; 1992 (ACT) sec 18; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 51.

2. Promotional competitions and the offering of gifts are covered by legislation in all jurisdictions covering lotteries, gambling and trading stamps. See, eg,

Lotteries Gaming and Betting Act 1966 (Vic); *Lotteries and Art Unions Act 1901* (NSW); *Art Unions Act 1992* (Qld); *Gaming Commission Act 1987* (WA); *Lottery and Gaming Act 1936* (SA); *Gaming Control Act 1993* (Tas); *Lotteries Act 1964* (ACT); *Gaming Control Act 1993* (NT).

3. TPC, *Advertising and Selling*, 2nd ed, 1991, *op cit*, p 45.

are obliged to incur additional expenses when claiming a gift or prize and this requirement was not specified ...

- *gifts or prizes* which are materially different to those offered, eg prizes of ‘up to \$10,000’ where the prize is actually a ticket in a \$10,000 lottery or where a ‘cash’ prize is actually a store credit.”

¶7-410 Misleading conduct to which the Industrial Property Convention applies: sec 55.⁴ Section 55 covers virtually the same activities as sec 52 and 53 with one major difference: the subject of the section is not a “corporation” but a “person”. Because the Commonwealth can only legislate on the specific areas outlined in the Commonwealth Constitution, all Commonwealth legislation must be clearly anchored in the Constitution. Section 55 is anchored in two ways: (i) trade and commerce (Constitution sec 51(i)) and (ii) external affairs (Constitution sec 51(xxix)).⁵ (Most of the other sections of the *Trade Practices Act* are anchored on the Commonwealth’s power to legislate with respect to corporations and interstate trade: ¶7-220.) These sections of the Constitution are set out at ¶1-475.

The scope of the external affairs power in sec 51(xxix) as a source of Commonwealth legislative power has been widened by important decisions of the High Court,⁶ and the High Court has confirmed words written in 1902 that “[l]egislation with respect to the enforcement of treaty obligations is clearly within the scope of ‘external affairs’.”⁷ No argument can be made that the legislation concerned may impinge upon constitutional powers of the Australian States, and such Commonwealth legislation can be effective against State governments and citizens of the States.

By virtue of sec 51(xxix) of the Constitution, effect is given in Australia by sec 55 of the *Trade Practices Act* to the international law embodied in the provisions of the 1967 Stockholm revision of the Paris Convention 1883 for the Protection of Industrial Property. The Paris Convention⁸ requires every signatory country to give to nationals of every other country the same protection of inventions, trade marks, patents, industrial designs, trade names and in respect of appellations of origin and unfair competition, as is given under the country’s national law to its own nationals.

4. Also *Fair Trading Act* 1987 (NSW) sec 49; 1987 (SA) sec 63; 1987 (WA) sec 17; 1989 (Qld) sec 44; 1990 (Tas) sec 20; 1992 (ACT) sec 19; *Consumer Affairs and Fair Trading Act* 1990 (NT) sec 47.

5. See, eg, Evans, Gareth, *The constitutional validity and scope of the Trade Practices Act* 1974 (1975) 49 ALJ 654 at pp 666, 668-669. The sections are set out at ¶1-475.

6. eg *Commonwealth v State of Tasmania* (1983) 158 CLR 1; (1983) 57 ALJR 450;

Naylor, A, *Australia’s treaty-making process — democracy in action?* (1995) 67 Reform 34.

7. Alfred Deakin, Attorney-General, 1902, *Opinions of Attorneys-General of the Commonwealth of Australia*, 1981, Vol 1, p 134, quoted in *Victoria v The Commonwealth* (1996) 70 ALJR 680 at p 687.

8. eg CCH *Australian Industrial & Intellectual Property* ¶41-360.

The conduct covered by the prohibition in sec 55 relates to (i) the nature, or (ii) the manufacturing process, or (iii) the characteristics, or (iv) the suitability for their purpose⁹ or (v) the quantity of goods (not services) which is proscribed.¹⁰ For example, a fine was imposed under sec 55 for facial tissues falsely labelled "100% cotton" which contained wood pulp.¹¹ The consequences of breach of sec 55 are penal, not civil.

Section 55 has already been relied on in various cases and its potential should not be overlooked by legal and business advisers.

¶7-415 Misleading conduct regarding services: sec 55A.

Section 55A¹² of the *Trade Practices Act* provides that a corporation "shall not, in trade or commerce, engage in conduct that is liable to mislead the public"¹³ as to the nature, the characteristics, the suitability for their purpose or the quantity of any services". This section, along with sec 53(aa) (¶7-310), sec 53(c) (¶7-330), sec 53(e) (¶7-350), sec 53(f) (¶7-360) and sec 74 (¶7-095), reinforces application of the Act to goods and to services (as defined in sec 4 (¶7-290)).¹⁴

— Case example —

Before the products were delivered from the overseas supplier as promised, D Pty Ltd started selling advertising space in "System 2000", a home calendar wall unit which carried the names and phone numbers of local traders. Even after receiving a fax from the overseas supplier to the effect that the products were not then available, D Pty Ltd and its sales staff continued to sell advertising space and in fact grossed over \$200,000 after receiving the fax. In proceedings brought by the TPC, D Pty Ltd and its managing director were convicted of breach of sec 55A for permitting sales staff to continue selling, because their inability to get supply meant the company's conduct was "liable to mislead the public as to ... [the] suitability for their purpose" of the advertising service. Penalties to deter were imposed of \$20,000 on the company, \$3,000 on the managing director herself (in default, imprisonment at the rate of \$25 per day of unpaid fine: ¶8-790), and orders of compensation

9. Compare fitness for purpose: ¶7-090.

10. The "prescribed publication of matter by a prescribed information provider" is removed from the operation of sec 55 by sec 65A: ¶8-910.

11. *TPC v Golden Australia Paper Manufacturers Pty Ltd* (1995) ATPR ¶41-370.

12. Also ASIC Act 1989 (Cth) sec 12DF; *Fair Trading Act 1987* (NSW) sec 50; 1999 (Vic) sec 11; 1987 (SA) sec 64; 1987 (WA) sec 18; 1989 (Qld) sec 45; 1990

(Tas) sec 21; 1992 (ACT) sec 20; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 48.

13. A bank's advice to its customer on foreign exchange loans is contractual and is not a representation to the public which may give rise to a claim under sec 55A: *Westpac Banking Corporation v Northern Metals Pty Ltd* (1989) ATPR ¶40-953.

14. The "prescribed publication of matter by a prescribed information provider" is removed from the operation of sec 55A by sec 65A: ¶8-910.

against the company and the managing director of \$16,320 to be paid to previous customers.

_____ *TPC v J & R Enterprises Pty Ltd*¹⁵ _____

¶7-420 Bait advertising: sec 56.¹⁶ State and Territory Consumer Affairs Reports showed that bait advertising was common at the time the Act was passed. In essence, the practice was to advertise goods at a special price without the backup of sufficient quantities to satisfy the demand engendered. Having “baited” the customer, the supplier could then “switch” the customer to normal lines or to a more highly priced line.¹⁷

Section 56(1) prohibits the advertising of goods at a specified price where the advertising corporation had reasonable grounds, or ought to have been aware of reasonable grounds, to expect that it would not be able to comply with the advertisement. A positive obligation is imposed by sec 56(2) on those who advertise goods to actually offer them for supply in reasonable quantities for a reasonable time. Section 56(3) provides for a defence where the advertiser has a “raincheck” policy or offers to supply equivalent goods. “Reasonableness” will depend on the types of goods and services offered and the way in which they are normally marketed.

Where non-availability results from causes outside the control of the advertiser, the general defences under the Act will be available.

¶7-430 Referral selling: sec 57. Section 57¹⁸ draws a fine line between “spotter’s fees”, where a person is paid a commission for introducing new business or the like, and fees paid which are contingent on an event occurring (such as the introduction of a new customer) after the consumer has entered a contract with the person paying the commission. The former is legal and good business; the latter is banned outright, whether or not there is consent on the part of the consumer, and whether or not there is any misrepresentation. The section is confined to the inducement of a “consumer” as explained in ¶7-012.

15. (1991) ATPR (Digest) ¶46-069; (1991) ATPR ¶41-133. Also convicted of breaches of sec 53(c), 53(g) and 58, and further fines imposed.

16. Also ASIC Act 1989 (Cth) sec 12DG; *Fair Trading Act 1987* (NSW) sec 51; 1999 (Vic) sec 17; 1987 (SA) sec 65; 1987 (WA) sec 19; 1989 (Qld) sec 46; 1990 (Tas) sec 22; 1992 (ACT) sec 21; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 52.

17. eg *Guthrie v Robertson* (1987) 13 FCR 336; (1986) ATPR ¶40-744, noted at ¶7-380.

18. For other jurisdictions, see ASIC Act 1989 (Cth) sec 12DH; *Fair Trading Act 1987* (NSW) sec 52; 1999 (Vic) sec 18; 1987 (SA) sec 66; (WA) sec 20; 1989 (Qld) sec 47; 1990 (Tas) sec 26A (added 1994); 1992 (ACT) sec 23; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 53.

¶7-440 Accepting payment without intending to supply as ordered: sec 58. Section 58¹⁹ catches the situation where a corporation accepts payment for goods or services where at the time of acceptance it —

- does not intend to supply the goods or services; or
- intends to supply goods or services materially different from those ordered (sec 58(a)).

This section also catches the situation where a corporation accepts payment for goods or services where there are reasonable grounds to expect that the corporation will not be able to supply either within the time specified in the contract, or, if no time is specified, within a reasonable time (sec 58(b)).

— *Case example* —

“Swingaway Asia”. A travel agent was charged under sec 58 for accepting deposits for a holiday advertised as 16 days which had one less day of shopping than stated in its brochure (ie 15 days). The travel agent was advised of the error by Qantas (the tour packager) but did not withdraw the brochure. The travel agent’s conduct breached sec 58, and it was fined \$3,000.

— *Dawson v World Travel Headquarters Pty Ltd*²⁰ —

¶7-450 Misleading representations about certain business activities: sec 59. Section 59²¹ prohibits false or misleading representations concerning the profitability, risk or any other material aspect of any business activity that is represented as one that can, or can to a considerable extent, be carried on “at or from a person’s place of residence”. The section covers representations of projected income from agricultural crops,²² as well as representations regarding home contract packing and other “cottage industries”.

In its booklet *Advertising and Selling*, the TPC has drawn the following conclusions on an advertiser’s obligation to disclose regarding business opportunities:²³

- Claims concerning profitability should reflect what an average person would achieve in normal circumstances.

19. Also ASIC Act 1989 (Cth) sec 12DI; *Fair Trading Act 1987* (NSW) sec 53; 1999 (Vic) sec 19; 1987 (SA) sec 67; 1987 (WA) sec 21; 1989 (Qld) sec 48; 1990 (Tas) sec 24; 1992 (ACT) sec 24; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 54.

20. (1981) 53 FLR 455; (1981) ATPR ¶40-193.

21. Also *Fair Trading Act 1987* (NSW) sec 54; 1999 (Vic) sec 20; 1987 (SA) sec 68; 1987

(WA) sec 22; 1989 (Qld) sec 49; 1990 (Tas) sec 25; 1992 (ACT) sec 25; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 49.

22. *TPC v Friendship Aloe Vera Pty Ltd* (1988) ATPR ¶40-892.

23. TPC, *Advertising and Selling*, *op cit*, pp 42-43.

- Estimates of profit should be based on reasonable predictions.
- Reasonable risks should be disclosed.
- Advertisements should disclose the minimum amount of capital investment required, together with details of expenditure, time involvement and market information.

— *Case example* —

A company and its directors promoted truck sales by offering to provide purchasers with “permanent” positions as owner drivers. The positions did not exist. Various false representations as to earnings were made. In some cases earnings were insufficient to cover truck repayments. The defendants were charged with breaches of sec 53(a), 53B, and 59(2), and all pleaded guilty. The company was fined a total of \$75,000, and the individuals involved were fined \$18,500, \$19,000 and \$8,000 respectively.

— *Wilde v Menville Pty Ltd & Ors*²⁴ —

¶7-460 Door-to-door sales harassment and coercion: sec 60.²⁵ Pressure tactics applied in connection with sales and debt collection (¶1-435) are governed by sec 60 of the *Trade Practices Act*, and State/Territory door-to-door sales legislation as well as common law and equitable principles. Laws for protection at a place of residence or at premises other than trade premises (as defined in the legislation) are seen to be necessary because of the special vulnerability and isolation of the customer in the door-to-door sales situation.

Section 60 of the TPA prohibits the use of “physical force or undue harassment or coercion in connection with the supply of or possible supply of goods or services to a consumer or the payment for goods or services by a consumer”.

Like its counterpart in State and Territory law, sec 60, in prohibiting “physical force or undue harassment or coercion”, aims at very serious interference with the consumer (as defined in sec 4B — ¶7-012) and it is likely that high pressure techniques or just being a nuisance would not necessarily be caught by the section. In addition, and in the absence of case law to assist, numerous other issues of statutory interpretation are raised by sec 60. Must actual force be used, or is a threat of force sufficient? Are harassing phone calls covered (see TPA sec 6(3): ¶7-220)?²⁶ Do moral and mental pressures to pay constitute “physical force or undue harassment or

24. (1981) 50 FLR 380; (1981) ATPR ¶40-195.

25. Also ASIC Act 1989 (Cth) sec 12DJ; *Fair Trading Act 1987* (NSW) sec 55; 1999 (Vic) sec 21; 1987 (SA) sec 69; 1987 (WA) sec 23; 1989 (Qld) sec 50; 1990 (Tas) sec 26; 1992 (ACT) sec 26; *Consumer Affairs and Fair Trading Act 1990* (NT)

sec 55; Consumer Credit Code sec 145; ¶14-160; see further *Undue harassment or coercion — an ACCC research project*, ACCC Journal, Issue 15, p 5 (June 1998).

26. The phrase “call on” in the *Door to Door Trading Act 1987* (WA) refers to personal attendance, not a telephone call: *Ham v Burgess* (1992) 7 WAR 98.

coercion"? Commencing legal proceedings which are not vexatious or an abuse of process is not undue harassment or coercion within the meaning of the Act.²⁷

State and Territory door-to-door sales legislation. All the States and Territories have similar legislation specifically designed to protect the customer in a door-to-door sales situation.²⁸

Model legislation for door-to-door sales, developed by Tasmania, has been adopted in most jurisdictions to protect the consumer in a door-to-door situation:

- of special relevance to the elderly and to rural consumers, door-to-door dealers may only call between 9 am-8 pm on weekdays; 9 am-5 pm on Saturdays and never on Sundays and public holidays;
- all goods and services are covered by the model legislation (except contracts for insurance and credit);
- there is a cooling-off period (usually 10 days), and no money (not even a deposit) may be accepted in that time.

The general regulation imposed by State and Territory law applies to a contract —

- made at the place of residence or employment of the purchaser²⁹
- which does not result from an unsolicited request by the purchaser to the seller.

In New South Wales, for example, a credit-purchase agreement, or an offer to enter a credit-purchase agreement is not enforceable by the vendor unless —

- the agreement or offer is in writing;
- a copy of this document is given to the purchaser, with a completed copy of the Statement (on the purchaser's right to terminate within ten days) and the Notice (a form for termination by the purchaser) as provided by the legislation.

— Case example —

If the "original approach" is by the consumer physically going to the trader's premises and requesting a salesperson to call, any contract signed in the home is regulated by the door-to-door sales legislation: D, a house-cladding company, was prosecuted for breaches of the Victorian door-to-door sales legislation including refusing to cancel contracts within the 10 day cooling-

27. *Campbell v Metway Leasing Ltd* (1998) ATPR ¶41-630.

28. See *Door-to-Door Sales Act 1967* (NSW); *Fair Trading Act 1999* (Vic) Pt 4 sec 59-82 (Off-Business-Premises Sales); 1989 (Qld) Pt III Div 4 sec 57-72; 1987 (SA) Pt III; *Door to Door Trading Act 1987*

(WA); 1986 (Tas); *Door-to-Door Trading Act 1991* (ACT); *Consumer Affairs and Fair Trading Act 1990* (NT) Pt VII.

29. The Act applies to employees and those in self-employment: *Commissioner for Consumer Affairs v Spadjan Pty Ltd* (1995) ATPR ¶41-416.

off period without incurring a penalty. D's defence — that because all its business resulted from advertising, it did not "cold canvass" — was rejected.

*Arnol v RBP Pty Ltd*³⁰ —

Similarly, if the original approach is by the salesperson at the showroom asking consumers whether they would like someone to visit their home to give a quotation, any contract signed in the home is regulated by the door-to-door sales legislation.³¹

The legislation allows the purchaser to terminate the contract with the statutory Notice provided and in the time provided. This is the "cooling-off" period; it varies from seven to ten days among the jurisdictions, and its time of commencement varies from the date of the agreement, the day after the date of agreement or the date upon which the Statement is given. Notice of termination must be delivered or posted. When served on the vendor, the following consequences flow:

- The agreement or offer is deemed to be rescinded by mutual consent.
- The vendor must within seven days refund moneys paid and redeliver any trade-ins.
- The purchaser must return the goods.
- If the goods are lost or damaged, the purchaser must compensate the vendor.

Enforcement of State door-to-door sales legislation. Contravention of the legislation exposes both the seller and the buyer to various legal sanctions. On the part of the seller, contravention gives rise to:

- liability for prosecution for an offence under the legislation;
- the likelihood that the contract will not be enforceable.

Common law and equitable principles. In addition to federal and State statutory remedies, it must be remembered that a contract induced by duress can be set aside at common law (§5-720). Similarly, a contract induced by undue influence can be set aside in equity (§5-710); the developing law of unconscionability combines both and provides further statutory and case law remedies for the person coerced (§5-730—§5-760).

¶7-470 Pyramid selling: sec 61. Pyramid or multi-level selling schemes were widespread in Australia until the 1970s. Section 61³² prohibits pyramid selling schemes, alternatively described as a "trading scheme"

30. (1991) ASC ¶56-079.

31. *Impala Kitchens Pty Ltd v Hager* (1992) ASC ¶56-134. See further Bond, C, *Getting consumers off the hook* (1992) 66 LIJ 668.

32. See also ASIC Act 1989 (Cth) sec 12DK; *Fair Trading Act 1987* (NSW) sec 56;

1999 (Vic) sec 22; *Fair Trading Act 1987* (SA) sec 70; 1987 (WA) sec 24; 1989 (Qld) Pt 3 Div 2A; 1990 (Tas) sec 26B (added 1994); 1992 (ACT) sec 27; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 56.

(involving goods or services) or a “scheme” (covering chain letters and other schemes with no distinctive consumer product but with benefits from recruitment). A pyramid selling scheme has been explained as follows:³³

“These companies operate by selling two commodities: goods and/or services for final consumption, and franchises to sell either these goods and/or services or further franchises. The emphasis of the organisations is entirely on the sale of franchises and the profits to be made therefrom. Each franchise-holder gains a commission from any new franchise-holder introduced by him, and in some companies from further franchise-holders introduced by those new franchise-holders. This process tends to become an endless chain, with far more franchise-holders than could possibly be justified by the market for whatever final consumption item is offered. When saturation point is reached and there are no new franchise-holders to be introduced, the chain tends to collapse and those who have not already had an opportunity to recoup their investment find it next to impossible to recoup by selling the final consumption item.”

— *Case example* —

\$1,000 for \$125. The TPC (now the ACCC) charged participant D under sec 61(2A) for participating in a scheme of the pyramid type. Under the scheme, D was to induce eight people to pay him \$125 to join an imaginary train. The money would then pass up the pyramid to the person at the apex (the train engineer) who would collect \$1,000 from the eight. The original pyramid would then split and each participant would move up a level, so that those coming in at \$125 would receive \$1,000 from those below. Due to evidence of the good character of D and the nature of the offence, the charges, though proved, were dismissed.

— *TPC v Parker*³⁴ —

¶7-490 Inertia selling: sec 63A, 64, 65. Inertia selling of unsolicited goods or services is prohibited by the *Trade Practices Act 1974* (Cth). “Unsolicited” goods or services are sent or supplied to a person without any request. The items, supplied without order or payment but subject to a right to payment being asserted later, are sold by the buyer’s being bluffed into a contract, or by inertia. Not all buyers are aware that under contract law a supplier cannot deem silence to be consent in order to enforce a “contract” when the item is not returned or paid for in the time specified (¶5-310).

Section 63A,³⁵ which prohibits unsolicited credit cards, was added to the Act in 1975 following the widespread circulation of unsolicited Bankcard cards at their launch in 1974.

33. Commissioner for Prices and Consumer Affairs (SA), *Annual Report*, 1973, p 11.

34. (1990) ATPR ¶41-055; (1990) 97 ALR 403; similarly, *ACCC v Golden Sphere International Inc and Reynolds* (1998) ATPR ¶41-638, noted ACCC Journal, Issue 15, p 26 (June 1998); *ACCC v Giraffe World Australia Pty Ltd* [1999]

FCA 1161; (1999) ATPR ¶41-718 (ion mat scheme).

35. Also ASIC Act 1989 (Cth) sec 12DL; *Fair Trading Act 1987* (NSW) sec 57; 1999 (Vic) sec 23; 1987 (SA) sec 71; 1987 (WA) sec 28; 1990 (Tas) sec 27; 1992 (ACT) sec 28; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 57.

Section 64³⁶ prohibits the assertion of a right to payment for unsolicited goods from an involuntary bailee (§15-060) (sec 64(1)), unsolicited services (sec 64(2A)) and unauthorised directory entries (sec 64(3)). A “directory” has been held to exclude a quarterly Gold Coast tourist publication featuring advertisements relating to the area.³⁷

— *Example: “telefraud”* —

Catching out the sleeping partner

“Blower: ‘Statewide Services Directory here, just checking the copy of your entry.’

Trader: ‘What entry?’

Blower: ‘Your partner okayed it last week.’

Trader: ‘All right, go ahead.’”

— *TPC campaign against “blowers”*³⁸ —

This and other examples of “blowing” (because of its use of the phone — the “blower”) have long been an issue, but they are now in decline as they have been targeted since 1987 by the Trade Practices Commission (now the Australian Competition and Consumer Commission).³⁹

The recipient is not liable to make payment for unsolicited goods, and is not liable for loss or damage to them unless this is caused by a wilful and unlawful act of the recipient (sec 65).⁴⁰ The supplier cannot imply acceptance of unsolicited goods by the fact that the recipient has sold some of the goods and sent payment to the supplier for each unit sold.⁴¹

¶7-495 Product safety and product information: sec 65B-65R. The prescription of safety and information standards by government is an important legislative means of consumer protection.

36. Also ASIC Act 1989 (Cth) sec 12DM; *Fair Trading Act 1987* (NSW) sec 58; 1999 (Vic) sec 24, 27, 28; 1987 (SA) sec 72; 1987 (WA) sec 29; 1989 (Qld) sec 52; *Unordered Goods and Services Act 1973* (Tas); 1992 (ACT) sec 29; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 58.

37. *Good v Kennan* (1990) ATPR ¶41-039; also reported under the name *Kennan v Monahan* [1991] 1 Qd R 401 (therefore the advertiser could not plead failure to authorise the entry in writing under sec 64(6) as a defence to action by the publisher for the advertising fee).

38. “TPC campaign against ‘blowers’ announced”, December 1987. See further TPC, *Telefraud — new name for an old scam — don’t pay for ads you didn’t order*, 1994.

39. eg, under former sec 64(2B), *O’Connor v Stevenson* (1990) 21 FCR 344; (1989) ATPR ¶40-944 (New South Wales magazine publisher fined \$72,000 for “blowing”); *TPC v Quality Publications Pty Ltd* (1990) ATPR ¶40-991 (magazine publishing company fined \$25,500 and its national advertising manager fined \$2,550 personally for “blowing”).

40. Also *Fair Trading Act 1987* (NSW) sec 59; 1999 (Vic) sec 25-26; 1987 (SA) sec 73; 1987 (WA) sec 31; 1989 (Qld) sec 53; 1992 (ACT) sec 30; *Unordered Goods and Services Act 1973* (Tas); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 59; ¶5-310.

41. eg *Jaczlow Pty Ltd (Receivers & Managers appointed) v Amberley Autos Pty Ltd* (1992) ATPR ¶41-177.

Product safety standards. A consumer product safety standard consists of such requirements as to (sec 65C(2)):⁴²

- “(a) performance, composition, contents, methods of manufacture or processing, design, construction, finish or packaging of the goods;
- (b) testing of the goods during, or after the completion of, manufacture or processing; and
- (c) the form and content of markings, warnings or instructions to accompany the goods,

as are reasonably necessary to prevent or reduce risk of injury to any person”.

A corporation must not supply goods intended or likely to be used by a consumer if the goods do not comply with a prescribed standard or if the goods have been declared unsafe by notice, or if the goods are subject to a permanent ban by notice (sec 65C(1)).⁴³ For example, an importer was charged by the ACCC, convicted and fined \$25,000 under sec 79 for supplying both swimming aids and sunglasses which did not comply with the relevant consumer product safety standard.⁴⁴

Product information standards. A product information standard consists of such requirements as to (sec 65D(2)):⁴⁵

- “(a) the disclosure of information relating to the performance, composition, contents, methods of manufacture or processing, design, construction, finish or packaging of the goods; and
- (b) the form and manner in which that information is to be disclosed on or with the goods,

as are reasonably necessary to give persons using the goods information as to the quantity, quality, nature or value of the goods”.

Where there is a product information standard in force, a corporation must not supply goods unless it has complied with the standard (sec 65D(1)).

Enforcement of these provisions is a responsibility of the Australian Competition and Consumer Commission (the ACCC) (¶7-910; ¶8-725).

42. Also, eg, *Fair Trading Act 1987* (NSW) sec 26(2); 1999 (Vic) sec 34; 1987 (WA) sec 50(2); 1989 (Qld) sec 83(2). *Trade Standards Act 1979* (SA) allows for temporary bans on dangerous and potentially dangerous goods and product recall systems for dangerous goods based on TPA Pt V Div 1A; *Consumer Affairs Act 1973* (ACT) sec 15FBA; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 25(2).

43. Many goods have been banned by the Minister with an unsafe goods declaration under sec 65C(7): eg “QUICKIE Line Release” for water skiers (May 1993); gas masks containing asbestos in the filter component (July 1993). Also *Fair Trading*

Act 1987 (NSW) sec 27; 1999 (Vic) sec 33; 1987 (WA) sec 51; 1989 (Qld) sec 85; *Trade Standards Act 1979* (SA); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 25.

44. *ACCC v MNB Variety Imports Pty Ltd* (1998) ATPR ¶41-617; see further *ACCC v Hungry Jack's Pty Ltd* (1996) ATPR ¶41-538, noted at ¶8-830.

45. Also, eg, *Fair Trading Act 1987* (NSW) sec 38(2); 1999 (Vic) sec 47; 1987 (WA) sec 59(2); 1989 (Qld) sec 81(2); *Trade Standards Act 1979* (SA); *Consumer Affairs Act 1973* (ACT) sec 15FCA; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 38.

For example, action by the ACCC against the importer of Kretek “clove” cigarettes in 1999 resulted in the cigarettes being withdrawn from sale because they did not comply with the tobacco product information standard on labelling and health warnings.⁴⁶

Section 65E gives the Minister (the Minister for Financial Services and Regulation) the power to prescribe standards prepared or approved by the Standards Association of Australia (¶7-910) or other prescribed body as legal standards under the Act. The section does not mean that all of these standards become law, but only those formally prescribed. The reasoning behind this section gives recognition to the work of Standards Australia in developing voluntary standards relating to consumer products and, in particular, standards relevant to the safety aspects of consumer products.

The effect of these sections is that a corporation which sells goods in contravention of a product standard or unsafe goods order may be prosecuted by the ACCC. If the contravention is proved, a fine may be imposed under sec 79 of the Act.⁴⁷

Compliance with a safety or information standard may be a defence against product liability (¶7-215).

Product recall orders. Consumer goods which may cause injury, or which do not comply with a prescribed consumer product safety standard, or which have been declared by ministerial notice to be unsafe should not be on the market. A court can order a product recall for breach of sec 65C⁴⁸ or 65D. If voluntary recall measures do not exist (cf ¶7-215), or if recall action by suppliers is unsatisfactory, sec 65F empowers the Minister to order a mandatory product recall or to require disclosure to the public of the nature of the defect and procedures for disposing of the goods. The power to issue this order is subject to the right to a hearing (sec 65J) except where there is a danger to the public (sec 65L)). Section 65G requires compliance with a product recall order, and this is encouraged by sec 65H which “deems” loss

46. ACCC Media Release 53/99 (6 May 1999).

47. Also *Fair Trading Act 1987* (NSW) sec 62; 1999 (Vic) sec 38, 44, 142; 1987 (SA) sec 75; 1987 (WA) sec 69; 1989 (Qld) sec 92, 98; 1990 (Tas) (each penal section states own penalty); 1992 (ACT) sec 41; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 88. See, eg, *O'Bryen v Coles Myer Ltd* (1993) ATPR ¶41-209 (nightdresses mislabelled for fire safety: fine of \$52,000 imposed for five breaches of sec 53(a) (¶7-300) and five breaches of sec 65C(1)(a)).

48. eg as with motorcycle helmets which failed a compliance test by a laboratory associated with the road traffic authority: *ACCC v MHG Plastic Industries Pty Ltd* [1999] FCA 788; (1999) ATPR ¶41-712. This product recall is likely to cost the manufacturer about \$5m. See generally Taylor, L, *Product safety standards under the Trade Practices Act — the cost of compliance* (2000) 14 *Commercial Law Quarterly* 12.

or damage caused by a defect in the goods or caused by lack of information about unsafe characteristics of the goods to be caused by such non-compliance.⁴⁹

Federal/State/Territory overlap. All jurisdictions have product safety legislation.⁵⁰ To enhance Australia-wide uniformity and mutual recognition, the Commonwealth, State and Territory governments agreed in 1992 on a list of 30 national product safety standards or information standards (on items such as dust masks and kerosene heaters) and national bans (on goods such as gas masks with asbestos, and tinted car headlight covers).

In addition, the federal, State and Territory governments agreed in 1992 on principles of mutual recognition of each other's standards, labelling, etc to remove artificial barriers to national trade in goods.⁵¹

Review of product safety system. A discussion paper aimed at enhancing the product safety system was released in 2000 with proposals including stronger incentives for suppliers to comply with the provisions, accrediting standards setters in addition to Standards Australia (such as some overseas agencies), requiring immediate advice to the government of a voluntary product recall in the case of a defective product, and providing for compliance with voluntary safety standards.⁵²

INDUSTRY CODES OF CONDUCT

¶7-500 **Legal recognition of codes of conduct: Part IVB.** Amendments to the *Trade Practices Act 1974* (Cth),⁵³ which commenced in 1998, give legal recognition to industry codes of conduct designed by and agreed to by the industry.

49. Also *Fair Trading Act 1987* (NSW) Pt 3 Div 3; 1999 (Vic) Pt 3 Div 3; 1987 (WA) Pt V Div 3; 1989 (Qld) Pt 4; sec 103A; *Trade Standards Act 1979* (SA); *Consumer Affairs Act 1973* (ACT) Part IIIB; *Consumer Affairs and Fair Trading Act 1990* (NT) Pt IV Div 3 (product recall).

50. eg *Consumer Affairs Act 1971* (WA) Part IIIA, providing for the Consumer Products Safety Committee.

51. eg *Mutual Recognition Act 1992* (Cth) and equivalents in each State and Territory: *Mutual Recognition (New South Wales) Act 1992* (NSW); *Mutual Recognition (Victoria) Act 1993* (Vic); *Mutual Recognition (Queensland) Act 1992* (Qld); *Mutual Recognition (South*

Australia) Act 1993 (SA); *Mutual Recognition (Western Australia) Act 1995* (WA); *Mutual Recognition (Tasmania) Act 1993* (Tas); *Mutual Recognition (Australian Capital Territory) Act 1992* (ACT); *Mutual Recognition (Northern Territory) Act 1992* (NT). The legislation also removes barriers to mobility of labour.

52. *Product safety policy review discussion paper*, 2000, noted at CCH *Australian Trade Practices Reporter* ¶30-207; available at www.treasury.gov.au.

53. *Trade Practices Amendment (Fair Trading) Act 1998* (Cth). Also *Fair Trading Act 1999* (Vic) Pt 6.

An industry code of conduct regulates the conduct of participants in an industry towards other participants in the industry or towards consumers in the industry.

Some codes are mandatory (sec 51AE(b)), and bind all the participants in an industry, such as the Franchising Code (¶9-986). Others are voluntary, setting best practice standards (sec 51AE(c)), and bind only those persons who agree to be bound. The codes are to be drafted after an appropriate approval process in the industry, and are to be tabled in the Commonwealth Parliament where they can be disallowed.⁵⁴

The object of Part IVB is to overcome the effect on small business of:

- information asymmetries in negotiation of contracts;
- inability to understand documents;
- unfair contract terms — especially those imposed rather than negotiated;
- unfair conduct within commercial relationships; and
- difficulties in resolving disputes in a timely and cost-efficient manner.

There was evidence before the Reid Committee⁵⁵ that such conduct is especially prevalent in the areas of franchising (¶9-985) and retail tenancies (in shopping complexes).

Section 51AD prohibits a corporation from contravening an applicable industry code. Breach attracts a wide range of sanctions under the *Trade Practices Act* including injunctions (¶8-810) and damages (¶8-840). The industry codes of practice are enforceable by private action, and by the ACCC — the ACCC will normally pursue test cases and cases of broad industry significance.

PRICE EXPLOITATION IN RELATION TO THE GST

¶7-505 Profiteering under the GST. The federal government expects that competitive pressures in the Australian economy should ensure that the tax reductions promised by the introduction of Australia's GST (goods and services tax, called "A New Tax System" in the *Trade Practices Act*) are passed on to consumers in the form of lower prices. In situations where price exploitation could occur, the ACCC has been given wide powers

54. The Policy Guidelines which set out how the government proposes to prescribe industry codes of conduct are reproduced at CCH *Australian Trade Practices Reporter* ¶30-166; www.treasury.gov.au.

55. As set out in *Finding a Balance*, AGPS, 1997 (the Reid Report).

under Part VB of the *Trade Practices Act*,⁵⁶ in force from 9 July 1999, to monitor possible exploitation of consumers and excessive profit taking by businesses in the transition to the GST in 2000.⁵⁷

Part VB prohibits “price exploitation” in the two-year transitional period after implementation date (sec 75AU).

Section 75AU explains that price exploitation in relation to GST means:

- the price for the supply is unreasonably high, having regard alone to the GST changes; and
- the unreasonably high price is not attributable to suppliers’ costs, supply and demand conditions or any other relevant matter.

In addition, sec 75AYA, in force from 22 June 2000, gives the ACCC power to prosecute for misrepresentations concerning the GST changes.⁵⁸

The ACCC has already taken action in 1999 under sec 52, 53(aa), 53(c), 53(d) and 55A of the Act for a bogus GST registration scheme.⁵⁹

The ACCC can apply to the Federal Court for penalties of up to \$10m for a body corporate and up to \$500,000 for an individual (sec 76(1)(a): ¶8-770), an injunction (sec 80: ¶8-810), an order limiting prices or requiring refunds of money (sec 80B: ¶8-750), and the ACCC or the Treasury can accept voluntary enforceable undertakings (sec 87B or 87C respectively: ¶8-866).

In addition, the ACCC can issue notices of two kinds:

- a notice of contravention of the prohibition against price exploitation, which will be evidence which can be used in later court proceedings under sec 76 (pecuniary penalties) or sec 80 (injunctions) (sec 75AW);

56. *A New Tax System (Trade Practices Amendment) Act 1999* (Cth). Because this federal legislation cannot apply Australia-wide without the co-operation of the States and Territories, mirror legislation called the “New Tax System Price Exploitation Code” has been passed by each State and Territory; eg the *Price Exploitation Code (New South Wales) Act 1999*, in force 10 December 1999. The ACCC released its draft Pricing Guidelines in 1999 to determine when prices may be regarded as in breach of the Act, available from www.accc.gov.au.

57. Australia’s goods and services tax (GST) was introduced by *A New Tax System (Goods and Services Tax) Act 1999* (Cth) and related legislation.

58. Introduced by *A New Tax System (Trade Practices Amendment) Act 2000* (Cth), based on a referral of power from all States except Queensland.

59. *ACCC v Australian Taxation Services*, Federal Court, 9 July 1999, noted Arscott, P, *Scam artists take advantage of uncertainty over the new tax system*, ACCC Journal, No 24, p 52 (December 1999). See generally Butcher, A, *ACCC briefed on GST price exploitation*, LSJ, Vol 38, No 1, p 48 (February 2000); Sweeney, B, *Trade Practices Act 1974 (Cth) and the New Tax System changes* (2000) 3 *Journal of Australian Taxation* 107.

- a notice “to aid prevention of price exploitation” — a notice specifying a maximum price which the ACCC believes may be charged (sec 75AX).

CAR TRADERS LEGISLATION

Overview of motor vehicle sales legislation	¶7-510
Agreements for sale	¶7-580
Guarantees	¶7-600
Exclusions from dealer liability for repair	¶7-610
Miscellaneous provisions	¶7-640

¶7-510 Overview of motor vehicle sales legislation. The second largest item the average consumer is likely to purchase, after a house, is a car. In response to consumer demand, and in addition to the efforts of the industry to regulate its members and to maintain good trading ethics and practices, the sale and purchase of motor vehicles is now primarily regulated by the following laws, which have as their main aim the protection of the consumer and the equalising of the balance in contractual relations:

- common law principles from the law of contract (Chapters 5 and 6), with statutory updates such as unconscionability law (¶5-730—¶5-760);
- the *Trade Practices Act* (¶7-216ff);
- sale of goods legislation (¶7-015ff);
- in some jurisdictions, a code of practice enacted under the *Fair Trading Act*;⁶⁰
- chattel securities legislation in most jurisdictions dealing with ownership problems (¶14-320—¶14-380); and
- car traders legislation of States and Territories.⁶¹ This legislation sets up a licensing system and regulation for car traders, and in some jurisdictions the motor vehicle repair trade.

The discussion here mainly deals with the latter legislation, outlining common features. New car sales are generally covered by general principles outlined earlier, although some Acts regulate both new and second hand car sales. In all jurisdictions except Tasmania, motor vehicle dealers must be licensed. Dealers are also subject to certain obligations in relation to the

60. eg *Fair Trading (Code of Practice for Motor Vehicle Traders) Regulations 1996* (Tas).

61. eg *Motor Car Traders Act 1986* (Vic); *Motor Dealers Act 1974* (NSW); *Auctioneers and Agents Act 1971* (Qld) especially Pt 5 Div 5 sec 57-68 (this Act, administered by the Department of Consumer Affairs, deals with, inter alia, auctioneers, real estate agents, commercial

agents and motor dealers); *Second-hand Dealers and Collectors Act 1984* (Qld); *Second-hand Motor Vehicles Act 1983* (SA); *Motor Vehicle Dealers Act 1973* (WA); *Second-hand Dealers and Pawnbrokers Act 1994* (Tas); *Sale of Motor Vehicles Act 1977* (ACT); *Consumer Affairs and Fair Trading Act 1990* (NT). See, eg, Maynard, A, *How to get out of a car contract*, Melbourne, Consumer Credit Legal Service, 1991.

motor vehicles offered or displayed for sale. Machinery has been established to deal with disputes should they arise.

¶7-580 Agreements for sale. Agreements for the sale of a motor vehicle must generally:

- be in writing (in most jurisdictions), signed by or on behalf of the vendor and purchaser;
- contain details of the vehicle such as engine number and registration number, price, charges, trade-in details, odometer reading;¹ and
- contain a statement by the licensee guaranteeing clear title to the motor vehicle.²

In some jurisdictions, apart from the ACT and Western Australia, a copy of the notice containing the particulars to be displayed must be signed by the dealer and the purchaser and given to the purchaser for retention. In Western Australia two copies of the notice are to be made out and signed by the dealer and the purchaser. One is to be handed to the purchaser for retention and the other to be kept with the notice by the dealer for at least 12 months.³

¶7-600 Guarantees. Car traders legislation in all States/Territories except Queensland provides statutory warranties for second hand vehicles,⁴ in addition to those provided by the *Sale of Goods Act* and (where applicable) the *Trade Practices Act 1974* (Cth) (¶7-011—¶7-205). These warranties apply only to vehicles within certain limits — for example, in New South Wales the car must be no more than 10 years old and have travelled less than 160,000 kilometres. In some jurisdictions a dealer must deliver to the purchaser an Inspection Report. If a defect appears in the vehicle within the period specified, the dealer must repair or make good the defect or cause the defect to be repaired or made good so as to place the vehicle in a reasonable condition having regard to its age. The wording in the Western Australian Act qualifies the word “defect”. There it is a “defect which renders or is likely to render the vehicle unroadworthy or unserviceable” which must be repaired.

In some jurisdictions, the dealer must fix a notice to vehicles offered for sale at a price below the warranty limit stating that there is no obligation to repair or make good any defects. Roadworthiness items may not be excluded

1. eg *Motor Car Traders Act 1986* (Vic) sec 41-42; *Second-hand Motor Vehicles Act 1983* (SA) sec 19; *Motor Vehicle Dealers Act 1973* (WA) sec 33(3); *Fair Trading (Code of Practice for Motor Vehicle Traders) Regulations 1996* (Tas) reg 10, 13; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 160.

2. *Motor Car Traders Act 1986* (Vic) sec 41; *Auctioneers and Agents Act 1971* (Qld) sec 60; Tas reg 16.

3. *Motor Vehicle Dealers Act 1973* (WA) sec 33(7).

4. Vic sec 54(1); NSW sec 27(1), Sch 1; SA sec 25, 26; WA sec 34(1); Tas reg 17; ACT sec 23(1) and (2); NT sec 168.

from the dealer’s warranty, and in some jurisdictions the dealer must deliver a roadworthy/inspection report (“pink slip”) with the vehicle.

¶7-610 Exclusions from dealer liability for repair. The dealer is not liable for the repair of defects which occur within the warranty period in the following cases:

- (a) where the defect arises from accidental or incidental damage that occurs after the taking of delivery;
- (b) where the defect is caused through misuse or negligence after the taking of delivery;
- (c) where the purchaser has had possession of the vehicle for three months prior to the sale; and (apart from the Northern Territory)
- (d) where a defect notice has been attached to the vehicle.⁵

¶7-640 Miscellaneous provisions. Other provisions include:

- (a) Penalties for false or misleading advertising, for failing to disclose that one is a dealer, or for proffering incomplete documents for signature.
- (b) The setting up of guarantee funds to provide compensation for purchasers who are unable to obtain redress from dealers for such matters as loss arising from the failure by the dealer to comply with the legislation, to transfer good title to the vehicle and to account to a person selling or trading in a vehicle to a dealer.⁶

SMALL CLAIMS TRIBUNALS AND OTHER COURT SUBSTITUTES _____

Rationale of Small Claims Tribunals ¶7-690
Major limitations: “trader”, “consumer” ¶7-700
Jurisdiction ¶7-710
Operation of Small Claims Tribunals ¶7-720
Specialist tribunals ¶7-730

¶7-690 Rationale of Small Claims Tribunals. The most practical way for a consumer to enforce consumer laws is to bring a claim in:

- the Small Claims Tribunal (in Queensland and Western Australia);
- the Consumer Claims Division of the Fair Trading Tribunal (in New South Wales);

5. Vic sec 55; NSW sec 29; WA sec 34(3); ACT sec 24(1); NT sec 169. 6. eg *Motor Dealers Act 1974* (NSW) Pt 6; *Auctioneers and Agents Act 1971* (Qld) sec 114-128.

- the Victorian Civil and Administrative Tribunal (under the Civil Claims List: ¶1-160); or
- the small claims jurisdiction of the Magistrates' Court (in South Australia, Tasmania and the ACT; Local Court in the Northern Territory).⁷

Claims may raise legal issues, but the tribunal is intended to operate as a problem-solving "inquisitorial" forum rather than using the "adversary" system (¶2-110). The South Australian Act, for example, says that the court "must act according to equity, good conscience and the substantial merits of the case without regard to technicalities and legal forms".⁸ Similar sentiments are reflected in some of the other jurisdictions.

Flexibility and informality is the essence of the tribunals. The tribunal is made up of a referee, who may or may not be qualified in law. In some jurisdictions, such as Queensland, the ACT and the Northern Territory, every magistrate is *ex officio* also a referee. Orders (in New South Wales, for example, money orders and work orders) can be made by the referee up to the maximum jurisdiction⁹ but are generally not enforceable by the tribunal itself.¹⁰ If the trader refuses to comply with the order, the claimant lodges the order with the Magistrates' Court (or equivalent) and the order is deemed to be an order of that court.

The goal of Small Claims Tribunals should be to provide easy access to affordable, speedy and fair dispute resolution.¹¹

¶7-700 Major limitations: "trader", "consumer". The major limitation of the tribunals in some jurisdictions (such as Western Australia) is that one party must be a "consumer" and the other a "trader" (as defined).

Trader. Although "trader" (or, in New South Wales, "supplier") is widely defined to include a person (including a company) carrying on a business of

7. First introduced in Queensland, where the Tribunal is the responsibility of the Queensland Department of Justice; the Tasmanian Act commenced full operation on 15 September 1985. *Victorian Civil and Administrative Tribunal Act 1998* (Vic) (VCAT); *Small Claims Act 1973* (Vic); *Fair Trading Tribunal Act 1998* (NSW); *Consumer Claims Act 1998* (NSW); *Small Claims Tribunals Act 1973* (Qld); *Small Claims Tribunals Act 1974* (WA); *Magistrates Court Act 1991* (SA) Pt V Div II (Minor Civil Actions); *Magistrates Court (Small Claims Division) Act 1989* (Tas); *Small Claims Act 1974* (ACT) and the *Small Claims Act 1974* (NT) which similarly grafted small claims on to the existing Magistrates' court structure.

8. *Magistrates Court Act 1991* (SA) sec 38(1)(f).

9. Vic \$10,000; NSW \$25,000; Qld \$5,000; SA \$5,000; WA \$6,000; Tas \$2,000; ACT \$5,000; NT \$10,000. Because a small claim is an amount less than the fixed maximum amount, a claim for the maximum is not a small claim and is beyond the Tribunal's jurisdiction: *Student Travel Australia Pty Ltd v Burton* (1988) ASC ¶55-652.

10. eg NSW sec 38, Div 4; Qld sec 22; WA sec 22; Tas sec 29; cf ACT sec 22, 23; NT sec 22, 23.

11. See further, eg, Mallam, B, *Consumer claims*, LSJ, Vol 34, No 2, p 53 (March 1996).

supplying goods¹² or providing services, and in at least Queensland and Tasmania¹³ includes a lessor of a dwelling house, the expression, except in South Australia and Tasmania, does not include a “private” person. This is a major limitation. It means that a person who wants the protection of the Small Claims Tribunal cannot take the risk of buying, say, a second hand washing machine from a private seller. It may be worth paying that extra amount to a dealer — who qualifies as a “trader” under the small claims legislation.

Consumer. Similarly, most jurisdictions limit claims to a private “consumer” (rather than a business person). A company or firm is generally not a consumer. A consumer does not buy goods for resale or hiring and does not buy goods or services in the course of a business.¹⁴

Some jurisdictions have widened the definition of consumer to include business consumers (eg New South Wales, Victoria and Queensland).

Enforcement capability is improved (eg by the publication of names of defaulting traders; Consumer Affairs assistance in follow-up Local Court proceedings or in company winding up proceedings) and procedural and administrative functions are enhanced (eg increased order-making powers, including delivery, return or replacement of goods).

¶7-710 Jurisdiction. The types of actions which the tribunals can determine cover a wide range:

- They can try an action for the payment of money, not exceeding the statutory limit,¹⁵ arising out of a contract involving the consumer and a trader, interpreted widely by the courts to include a claim against a retailer based on a manufacturer’s warranty¹⁶ or against any person who has a legal liability to the consumer.¹⁷
- In some jurisdictions, they can hear a claim for the relief of payment of such amounts.¹⁸

12. A panelbeater who occasionally sells cars he has improved is a “supplier” under the Act: *Carroll v Registrar, Consumer Claims Tribunal* (1993) ASC ¶56-215.

13. Qld sec 4 “trader”; WA sec 4 “trader”; Tas sec 3 “small claim”.

14. eg “Consumer” Qld sec 4; WA sec 4.

15. eg NSW sec 14; Qld sec 4, 16; WA sec 4, 16; Tas sec 3.

16. *R v Small Claims Tribunal and Munro; Ex parte Escor Industries Pty Ltd* (No 2) [1979] VR 635.

17. *Fairey Australasia Pty Ltd v Joyce* [1981] 2 NSWLR 314; (1980) ASC ¶55-091. There is no jurisdiction without legal liability: *Manufacturers Mutual Insurance Ltd v Peacock* (1988) ASC ¶55-627.

18. eg NSW sec 3(1) “consumer claim”; Qld sec 4 “small claim” (d); WA sec 4 “small claim” (c); Tas sec 3 “small claim”.

- They can hear a claim for the performance of work, including building work, valued at no more than the monetary limit,¹⁹ including in most jurisdictions work of a professional nature.²⁰
- In some jurisdictions they can determine small claims between landlords and tenants,²¹ and for payment of money for damage to property caused by or arising out of the use of a vehicle.²²

¶7-720 Operation of Small Claims Tribunals. Other important points to note about these tribunals are:

- Proceedings are final and in most jurisdictions there is no right of appeal for the loser.²³ However, where:
 - the tribunal has acted in excess of jurisdiction,²⁴ as set out in the definition of a “small claim” in the legislation, or
 - there has been a denial of natural justice,²⁵
 the loser may apply to a court to have the tribunal order set aside.²⁶
- Other parties can be “joined” in the proceedings quite easily, so long as they are given notice or convince the registrar that they have sufficient interest in the resolution of the dispute.²⁷
- Lawyers are not welcome as advocates: “Each party to a proceeding before a tribunal shall have the carriage of his own case.”²⁸ Lawyers can only appear in some jurisdictions if the other party and the referee agree.²⁹
- Costs cannot be awarded against the loser.³⁰

19. eg NSW sec 3(1) “consumer claim”, sec 10; Qld sec 4 “small claim”, 16; WA sec 4 “small claim”.

20. eg *Diskin Chiropractic Health Centre Pty Ltd v Molony* (1992) ASC ¶56-146 (chiropractor within jurisdiction).

21. eg *Small Claims Tribunals Act 1973* (Qld) sec 4 “small claim” (e); Tas sec 3 “small claim”.

22. eg *Small Claims Tribunals Act 1973* (Qld) sec 4(1) “claimant”.

23. eg Qld sec 18; WA sec 18; Tas sec 31; NT sec 19.

24. eg Qld sec 19; WA sec 19; Tas sec 32(2).

25. eg Qld sec 37; WA sec 36; Tas sec 32(2)(c); eg *Bruce v Wade* (1993) ASC ¶56-246

(trader, not notified that claim increased from \$400 to \$6,500, denied natural justice when order made).

26. Review is by way of a prerogative writ to the Supreme Court (¶1-165).

27. eg Qld sec 25, 26; WA sec 25, 26; Tas sec 17(2).

28. eg Qld sec 32; WA sec 32; Tas sec 22; NT sec 41.

29. eg SA sec 38(4)(a); WA sec 32(3).

30. eg Qld sec 35; WA sec 35; although in WA and Tas (sec 28) the tribunal has a limited right to grant costs. Costs can be awarded in SA: sec 38(5); NT: sec 29.

- Proceedings are in private in most jurisdictions³¹ and no publicly available verbatim law report is published.³² Statistics are published in all jurisdictions; sometimes they include claim particulars.³³
- Parties to a contract cannot exclude the jurisdiction of the tribunal. This is another instance of legislation preventing the contracting out of statutorily given rights³⁴ (cf ¶7-120ff).
- There are no technical limits on admissible evidence and opinions; hearsay and all relevant information are admissible.³⁵
- The Small Claims Tribunal is a court exercising judicial power and it is a court for all purposes.³⁶

Figures and reports indicate a real success rate for the operation of tribunals and the satisfaction of the parties. While it has been suggested that parties are railroaded into compromise or mediation at the cost of their full claim, one of Ralph Nader's personnel called the system "the best we found".³⁷ Certainly Australian statistics show annual increases in the use of the tribunal. Indeed, the informal settlement procedures which characterise the tribunals have formed the basis for the conferring of a mediation or an arbitration jurisdiction, as a means of alternative dispute resolution, on many courts.

¶7-730 Specialist tribunals. Recent years have seen an increase in the number of tribunals created by the legislature to operate alongside or in place of the ordinary civil jurisdiction of the courts (¶1-160). The possibility of a hearing before a non-court tribunal is not new, and private arbitration proceedings to settle, for example, building and insurance disputes, have existed in the legal system for many years. These proceedings are governed by the various Arbitration Acts (¶1-443), which provide for the settlement of civil disputes by what are in effect private court proceedings as an alternative to litigation in the courts. Commercial contracts often contain an arbitration clause.

31. eg Tas sec 23. Sec 33(1a) of the Western Australian Act provides inter alia that relatives and friends of a party, and Officers of the Department of Consumer Affairs, can be present during proceedings unless excluded by the Tribunal.

32. In some jurisdictions, such as Western Australia, a copy of decisions is sent to the Supreme Court Library where the parties are indexed.

33. eg Qld sec 42; WA sec 33, 41. For first hand accounts see, Evans, R, *Confessions of a small claimant* (1978) 3 Legal SB

132; Latimer, P, *Confessions of another small claimant* (1979) 4 Legal SB 7.

34. eg Qld sec 40; WA sec 39; Tas sec 5.

35. eg Qld sec 33; WA sec 33; Tas sec 25, 26.

36. *State Rail Authority of New South Wales v Consumer Claims Tribunal* (1988) 14 NSWLR 473 at p 478; (1988) ASC ¶55-692 at p 58,235.

37. eg Determan, DW, *The arbitration of small claims* 10 The Forum 831 at p 834 (1974-75).

In addition to private arbitration proceedings, the legal system provides for the following specialist tribunals:

Small Claims Tribunal (discussed above, ¶7-690—¶7-720).

Fair Trading Tribunal (NSW)/Credit Tribunal/VCAT (Vic). Some jurisdictions have set up tribunals — sometimes co-existing with the courts — to deal with problems, for example, to do with consumer credit, motor vehicles and motor vehicle repairs. In the case of the Victorian Civil and Administrative Tribunal (VCAT), 12 tribunals and authorities in Victoria such as the Credit Tribunal, the Small Claims Tribunal and the Travel Agents Licensing Authority were merged in 1998 into one “super tribunal”, headed by a Supreme Court judge.

National Native Title Tribunal commenced in 1994 to deal with claims for native title after *Mabo’s case* (1992: ¶1-455; ¶3-425).

Residential Tenancies Tribunal. This was a South Australian initiative, established under the *Residential Tenancies Act 1978* (SA) with jurisdiction over landlord and tenant disputes, and this lead has now been followed by some jurisdictions.³⁸ The tribunal has authority over residential properties owned by the Commonwealth government and its agencies.³⁹

INCREASING ACCESS TO THE COURTS

Pursuing consumer claims	¶7-750
Legal aid	¶7-760
Contingency fees	¶7-765
Class actions or grouped proceedings	¶7-770
Federal Court representative actions	¶7-780
Ancillary orders under <i>Trade Practices Act</i> : sec 87	¶7-850
Substituted actions	¶7-860

¶7-750 Pursuing consumer claims. The legal system for many people is “a closed system into which they cannot enter and for them justice is denied”.⁴⁰ One day in the Supreme Court may cost \$10,000 and a typical five-day commercial action could amount to \$100,000 not including the cost of filing fees, court transcripts, expert witnesses and other disbursements.⁴¹

38. eg *Residential Tenancies Act 1997* (Vic); 1987 (NSW); 1994 (Qld); 1995 (SA). In WA, Magistrates in the Small Disputes Division of the Local Court are invested with jurisdiction under the *Residential Tenancies Act 1987* (WA). The ACT established its Commercial and Tenancy Tribunal in 1994 to deal with disputes between landlords and small business tenants; ¶3-760.

39. *Re Residential Tenancies Tribunal of New South Wales*; ex parte *Defence Housing*

Authority (1997) 71 ALJR 1254 (operation of State legislation not inconsistent with Commonwealth legislation under Constitution sec 109: ¶1-475).

40. Burt, Chief Justice, *The moving finger or the irremovable digit* (1987) 61 ALJ 465 at p 469.

41. *The high cost of justice* (1990) 64 ALJ 167.

A vast body of consumer law will remain unavailable unless the law is easily accessible to the consumers it is designed to benefit. Rules and regulations which are ineffective are of academic, political or public relations importance only.

Consumer access to the legal system may be impeded by one or more of the following important factors:⁴²

Costs. The high costs of litigation will bar the poor from access to the court system. Costs can also act as a deterrent for a middle income earner who does not qualify for legal aid.

Unequal position of consumer v retailer. Many consumer complaints involve large institutional defendants — retailers, manufacturers, insurance companies and other parties that are familiar with the legal system and experienced in its operation. The typical consumer has no first hand experience, and is easily intimidated by an opponent that is authoritative and appears to have all the answers.

Ignorance of consumer rights. Consumer rights, such as those considered in this chapter, will be of no use to a consumer unaware of them. There is a consistently small minority of people who do not take any action about consumer problems because they do not know what to do and whom to approach, although community legal education is gradually providing some awareness. Consumers tend to regard the written word as law, and forms, documents and fine print as the final arbiter in a contractual dispute. Community distrust of the legal system (expense and delay), difficulties in communication, and inability or unwillingness to follow technical legal procedures may all discourage the exercise of the legal rights of consumers.

Access to the courts is in part assisted by such means as legal aid and representative actions (§7-760—§7-860); access to justice by other means is enhanced by the assistance of Consumer Affairs Bureaus, etc (§7-880), private “pro bono” schemes,⁴³ methods of alternative dispute resolution (§1-441—§1-444), and sometimes most effectively by publicity and other extra-legal methods (§7-940). Each party to pay its own costs and a specialist Commonwealth-funded Consumer Legal Advocacy Centre have been suggested as further means of effective enforcement of consumers’ rights.

§7-760 Legal aid. Store-front legal services, volunteer legal services and government-assisted legal aid schemes have evolved to represent another initiative for the possible benefit of the consumer.

Legal aid may consist of legal advice or legal assistance.

42. eg Goldring, J, *Why aren't consumer protection laws used?* (1993) 18 Alt LJ 275.

43. “Pro bono publico” (Latin: for the common good) legal work such as

Victoria's Public Interest Law Clearing House Inc, a non-profit association of private law firms, barristers and community legal centres.

Legal *advice* is available free or at a nominal charge from many sources: community legal centres, which are often staffed by volunteer lawyers; duty lawyers attached to courts; officers employed by the Legal Aid (or Services) Commissions, (or Offices); private practitioners whose services are made available through the government-funded Commissions, or schemes run by the local professional body such as the Law Society or Bar Association; the Aboriginal Legal Service, etc.

Legal *assistance* — that is, financial help with taking or defending legal proceedings in the courts — may be provided by the government in some situations.⁴⁴ It may also be available through the Legal Aid or Services Commissions or the ALAO in each State and Territory. Stringent tests are applied, assessing the financial means and needs of applicants and the merits of the case. Bodies corporate are not often eligible for assistance. Financial aid for consumer matters is usually restricted to cases of severe hardship or test cases involving some special public interest.

Legal *expense insurance* underwritten by private insurance companies is another method of providing protection against unexpected legal expenses so as to ensure access to justice.

Although a consumer or a consumer group can wage a campaign from outside the legal system (§7-940), the benefit of legal representation within the system cannot be overlooked. If one cannot afford it, or is unaware of it, legal aid and legal/community education may help to redress the balance.

§7-765 Contingency fees. Lawyers in the US and Canada can act for clients on the basis of the payment of a fee, negotiated in advance, known as a contingency fee, which represents a percentage of the judgment (if successful) or no fee (if unsuccessful). “No win — no pay” schemes in some jurisdictions are a step in this direction. Contingency fees have been supported by one of Australia’s most senior judges: “the contingency system does at least open the doors of the court to everybody who has a need which professional opinion is prepared to underwrite.”⁴⁵

§7-770 Class actions or grouped proceedings. Compensation for small losses or injuries is often not claimed because of legal costs and other barriers against access to the law such as time or place (whether real or perceived). Proceedings to allow individuals or businesses with similar claims against the same person to group together in the one legal action exist in all Australian jurisdictions through the existing representative action (see

44. eg under *Trade Practices Act 1974* (Cth) sec 170 (§8-810); *Fair Trading Act 1987* (NSW) sec 11A-17.

45. Burt, Chief Justice, *The moving finger or the irremovable digit* (1987) 61 ALJ 465 at p 469. Arguments for and against are set out in *Contingency fees: to have or*

not to have? (1990) 17 Brief 6; a “conditional success fee” was recommended by the TPC — the lawyer’s normal fee plus an increase of up to 25% of the fee, not a percentage of the court award or result: TPC final report on the legal profession, 1994.

below) and under sec 87 of the *Trade Practices Act 1974* (Cth) (¶8-860). The Commonwealth Parliament introduced representative actions in the Federal Court as from 1992 (¶7-780).

Existing representative actions. There is already a limited form of class action procedure available in common law jurisdictions which provides for a representative action.⁴⁶ A representative action allows a person to sue in the person's own name as plaintiff on behalf of specified other persons who have "opted in" and who have the same interest in the action. Cases allowing such actions go back to the early nineteenth century. The leading old "class action" authority is the *Duke of Bedford* case of 1901:

— *Case examples* —

Covent Garden Market belonged to the Duke of Bedford but an Act of 1828 fixed the rent and gave preferential rights to stands to various classes of growers. When the Duke sought to increase the rent, a group of stall holders (suing on behalf of themselves and all other stall holders) claimed a court declaration that the Duke had been charging more than the statutory rent. The representative suit was upheld by the court because three tests were satisfied: (1) the parties had common interests; (2) they had a common grievance, and (3) the action was beneficial to all whom the plaintiff proposed to represent. The fact that the individuals had separate individual actions was held to be no barrier to the representative action.

*Duke of Bedford v Ellis*⁴⁷ —

Two wheat farmers (P) entered a loan and chattel mortgage with Esanda Finance (D) (regulated by the then *Credit Act 1984* (NSW): ¶14-080). When they were unable to make the first interest payment, P negotiated a "variation agreement" (¶14-230). P alleged that the "amount financed" was overstated because D added the credit charges to the original amount borrowed without making the necessary disclosures as required by the legislation. P sued on behalf of themselves and all the other parties who entered into the same offending variation agreements with D. D's defence was that P failed to sufficiently define the persons on whose behalf they sued, and that P's claim should be struck out.

The High Court rejected D's defence, and confirmed that only two criteria had to be fulfilled under the Rule of Court on representative actions: (1) numerous persons with genuine claims against D, and (2) numerous persons with the same interest in the proceedings.

The Rule is intended "to facilitate the administration of justice by enabling parties having the same interest to secure a determination in one action rather than in separate actions." The Rule intends representative actions, not

46. Morabito, V and Epstein, J, *Class Actions in Victoria: Time for a new approach*, Attorney-General's Law Reform Advisory Council, Melbourne, 1997.

47. [1901] AC 1. *Prudential Assurance Co Ltd v Newman Industries Ltd* [1979] 3 All ER 507; noted (1980) 54 ALJ 688.

class actions, and even though the Rule is brief, it is to be read broadly so that a representative action can go ahead.

— *Carnie v Esanda Finance Corporation*⁴⁸ —

¶7-780 Federal Court representative actions. Acting on the Australian Law Reform Commission's Grouped Proceedings Report,⁴⁹ the Commonwealth Parliament amended the *Federal Court of Australia Act 1976* (Cth) as from 1992 by adding Part IVA to enable groups with common legal claims to bring representative actions.

A representative action may be commenced where the applicant has a personal cause of action against a defendant, the applicant represents a group of at least seven, and all the members of the group have a cause of action against the defendant arising from the same, similar or a related transaction with a common question of law or fact. The proceedings will be "opt out" — the applicant does not require the consent of each member of the group ("opt in"), but any group member can opt out of the proceedings.

— *Case example* —

Many customers fell ill after eating food contaminated with salmonella bacteria purchased from D's bakery. The Federal Court approved a settlement agreement under Part IV under which D contributed the proceeds of its public liability insurance (¶17-050) to a fund to be administered by the solicitor for the class as compensation for the members' physical loss (sickness) and financial loss (medical expenses, etc). The court approved a notice in the press informing those affected of their need to "opt in" within six weeks of the notice, and confirmed that the settlement did not bind those who opted out.

— *Lopez v Star World Enterprises Pty Ltd*⁵⁰ —

There are controls on grouped proceedings to prevent abuse of process. The court retains the power to stay or dismiss proceedings it considers vexatious, oppressive or trivial. However, the main control is financial self-interest: because the loser pays the winner's costs in the Australian legal system, commencement of proceedings without merit to force a settlement would be risky and unlikely. Further, members who are not formally party to the proceedings are not liable for costs.

— *Case example* —

A representative action under Part IVA was commenced in 1999 by six named applicants against three major tobacco companies. The applicants,

48. (1995) 182 CLR 398 at p 404. See further Semple, C, *Representative proceedings in Victoria*, LIJ, Vol 70, No 3, p 51 (March 1996). The case was referred back to the NSW courts, where it was discontinued: *Carnie v Esanda Finance Corporation* (1996) ASC ¶56-336. See further *Class actions* (1999) 73 ALJ 233.

49. ALRC, *Grouped proceedings in the Federal Court*, Report No 46, Canberra, AGPS, 1988; see further Baxt, R, *Class action legislation — a mirage for the consumer?* (1992) 66 ALJ 223; Williams, S, *A class act?* (1992) 66 LIJ 376.

50. (1999) ATPR ¶41-678.

suing for misleading or deceptive conduct in breach of sec 52 of the *Trade Practices Act* (§7-250) and negligence (§4-060) on behalf of themselves and a group listed in the Statement of Claim, are claiming compensation for smoking-related cancer and smoking-related non-malignant disease as a consequence of the use of cigarettes between 1996 and 1999. Evidence in the case shows that each year in Australia 18,000 deaths and 140,000 hospital admissions are attributable to cigarette smoking. Many defences have been raised and the case is continuing.

*Philip Morris (Australia) Ltd v Nixon*⁵¹ —

Representative actions under Part IV are only available for matters within the jurisdiction of the Federal Court (§1-110).

Part IV provides for the award of damages for group members, and the *Philip Morris case* confirms that the court can award exemplary damages (§4-200) in representative actions.

§7-850 Ancillary orders under *Trade Practices Act*: sec 87.

Section 87 of the TPA empowers the Federal Court to make ancillary orders on the application of the Trade Practices Commission appropriate to compensate, prevent or reduce loss or damage suffered by “a person who ... has suffered, or is likely to suffer, loss or damage by conduct of another person that was engaged in ... in contravention of a provision of Part IV or V” (sec 87(1)). This remedy, detailed at §8-860, also allows the court to make orders of wide effect on behalf of a person who is not necessarily party to trade practices proceedings (sec 87(1A)) where a contravention of Part V is involved.

§7-860 Substituted actions. As with Trade Practices legislation (§7-850, §8-860), Consumer Affairs legislation in most jurisdictions authorises the Director of Consumer Affairs or equivalent to commence or defend proceedings on behalf of consumers in certain circumstances.⁵² However, before commencing proceedings, the Director must be “satisfied” that the consumer has a cause of action and that it is in the “public interest”, and must have the written consent of the person on whose behalf the action is proposed.

Although action taken is in the consumer’s name, the proceedings are conducted by the Director of Consumer Affairs, who has control of the proceedings. The Director can settle, for instance, on the consumer’s behalf. Because it is litigated by the Director (ie the Consumer Affairs Bureau), the psychological and financial barriers that often block consumer claims are or

51. [2000] FCA 229; (2000) ATPR ¶41-759.

52. eg *Fair Trading Act 1987* (NSW) sec 72(4); 1999 (Vic) sec 105; 1987 (SA) sec 76; *Consumer Affairs Act 1971* (WA) sec 18; query *Consumer Affairs Act 1988* (Tas) sec 11(1)(a); *Consumer Affairs Act 1973*

(ACT) sec 15F; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 9(3). Sec 100 of the *Fair Trading Act 1989* (Qld) is the equivalent of TPA sec 87. The *Fair Trading Act 1990* (Tas) does not contain such a provision.

should be removed. There is no means test, although the Director may refuse assistance because of the applicant's financial position.

The substituted action is ideal for the big test case on behalf of consumer interests, involving principle rather than price. Grants of legal assistance have been made in many jurisdictions.

ADMINISTRATIVE ACTION _____

Development of consumer legislation	¶7-870
Consumer Affairs Bureaus	¶7-880
Private consumer organisations	¶7-890
Consumer information	¶7-910
Advertising Standards Council	¶7-930

¶7-870 Development of consumer legislation. The development of the consumer movement leading to such organisations as Consumer Affairs Bureaus goes back more than 60 years. In 1927 a book called *Your Money's Worth* by Stuart Chase and Frederick Schlink, which dealt in a forthright way with advertising that was misleading to the extent of being fraudulent, was published in the United States and quickly became a bestseller. One of the book's proposals was for a clearing house for consumer market information. An embryonic Consumers' Club was formed as a result, a club which grew into the powerful United States Consumers' Union with its millions of members. In the United Kingdom the Consumers Association was formed in 1956 and was an immediate success. In 1959 the Australian Consumers' Association was formed. The growth of the voluntary consumer movement was the forerunner of the enactment of consumer protection legislation in each jurisdiction.

¶7-880 Consumer Affairs Bureaus. The Commonwealth and all States and Territories have instrumentalities, such as bureaus or departments, for the protection of consumers. A major portion of their activities concerns the promotion of consumer awareness (education, information, collection and collation of data). Other activities include the provision of consumer information to consumers, producers, manufacturers, etc, the handling of complaints, and in some jurisdictions the enforcement of consumer legislation (including licensing and registration). Many bureaus have the power to take the initiative to inspect and investigate which may lead to prosecutions for breaches of consumer legislation. In the Commonwealth area, the Consumer Affairs Division of the Department of Treasury has a policy-making and educational role, while the ACCC has responsibility for enforcement. See also ¶7-910.

¶7-890 Private consumer organisations. Numerous private consumer organisations such as the ACA and the CFA provide consumer services such as information, representation and testing.

¶7-870

ACA. The Australian Consumers' Association undertakes comparative testing which is published in its widely circulating CHOICE magazine. The ACA supplies answers to consumer questions, handles complaints and has expanded its public education role through the establishment of "CHOICE LINES", a recorded information service.

CFA. The Consumers' Federation of Australia was re-formed in February 2000 with a new focus on low income and disadvantaged consumers. CFA acts as a peak body for Australian consumer groups, with a direct membership of around 60 organisations. CFA has also established networks of consumer activists and organisations on specific issues, including the Financial Services Network (150 members) and the Consumers' Food Network (200 members). CFA also assists in the coordination of consumer representatives on Standards Australia technical committees.

¶7-910 Consumer information. Consumer Affairs Bureaus and the ACCC produce reports, pamphlets, information sheets and booklets which are available to consumers and are widely distributed. These cover such topics as consumers and refunds, warranties, door-to-door sales, motor vehicles, hire-purchase/credit, home building and buying real estate. The Code of Practice issued by the former Trade Practices Commission (now the ACCC) and the Australian Retailers Association in September 1989 on computerised supermarket checkout systems provides that if the price on the docket is higher than the shelf price, the shopper is to receive the item free. Further, Consumer Affairs Bureaus provide schools programs and kits for teachers, as well as talks to trade, professional, educational, migrant, welfare and private groups. Newspapers, television and radio stations often assist consumer affairs, with talkback radio, special reports and the other forms of media attention (see ¶7-940).

Other avenues of consumer education and assistance include, for example, professional and industry associations, social welfare agencies, government departments and government-supported advisory services, and interest groups representing motorists, home unit owners, tenants, etc.

Testing is an effective means of providing consumer protection and information. Testing is carried out by such organisations as:

- Standards Australia (¶7-495);
- the Australian Wool Testing Authority (textile products, carpets, etc);
- the Australian Consumers' Association (¶7-890).

Enforcement of the product safety and product information provisions of the *Trade Practices Act 1974* (Cth) is a responsibility of the ACCC. In addition, each State and Territory has equivalent product safety legislation. (See ¶7-495.)

¶7-930 Advertising Standards Council. Advertising content is regulated by legislative controls on misleading or deceptive advertising (¶7-250ff), such as codes of practice under the *Fair Trading Act* in most

jurisdictions⁵³ as well as by legislation requiring specific information in such areas as building work; credit, real estate and travel advertisements; and dealings in used cars. In addition, advertising content is influenced by the advertising industry, through codes and structures authorised by the Australian Competition Tribunal (¶8-730) and administered by industry bodies under the umbrella of the Media Council of Australia. One such body is the Advertising Standards Council, which as from 1993 works with and exchanges information with the ACCC. These voluntary codes and the decisions of the Council do not have the force of law, but draw their force from agreement among and acceptability to the interested parties in the relevant industry.

EXTRA-LEGAL REMEDIES

¶7-940 Publicity and other persuasive pressures. A number of possible “extra-legal remedies” have been tried as a means of providing consumer redress and pressing for changes to the law, such as media attention, strikes and boycotts, pressure from the offender’s peer group, and representation by the local Member of Parliament.

Consumer Affairs Bureaus often provide the link between cases of consumer abuse and media publicity. This is a valuable function of the bureaus, and has led to media reports and action on numerous consumer abuses.

Popular current affairs programs on television and radio have a role to play in this area. Fuelled with media publicity and wide public awareness, the power of the strike (the shoppers’ strike) or the boycott (the consumer boycott) is considerable. Also, drawing public awareness to deeply held beliefs can serve a powerful purpose. The campaign waged by BUGA UP (Billboard Using Graffitiists Against Unhealthy Promotion) for over a decade in disfiguring cigarette billboards has been so concerted as to lead tobacco companies to hire security guards to protect cigarette advertising billboards.⁵⁴

The ability of one’s elected representative — whether at local, State/Territory or federal level — to act on one’s behalf should also not be overlooked.

53. eg 1987 (NSW) Pt 7; 1999 (Vic) Pt 6; 1987 (WA) Pt IV; 1989 (Qld) Pt 4 Div 5 (added 1994); 1990 (Tas) Pt 4; 1992 (ACT) Pt III; 1990 (NT) Pt XII.

54. Slogans include “Welcome to cancer country”, “Preferred by 5-to-12-year-

olds”; “The Golden Finger of Death”; “Poison”. See further Chesterfield-Evans, A and O’Connor, G, *BUGA UP progress four years on*, in World Conference on Smoking and Health, *Proceedings*, No 6, 1987, p 369.

Chapter 8

Trade Practices

Important Note: On 6 November 1995, the Trade Practices Commission (TPC) merged with the Prices Surveillance Authority (PSA) to become the Australian Competition and Consumer Commission (ACCC). All references to the former authorities (including case citations) should be read as references to the ACCC from that date.

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TRADE PRACTICES — AN OVERVIEW

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Scope of the Act	¶8-020
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¶8-010 Why a *Trade Practices Act*? The *Trade Practices Act 1974* (Cth) came into effect on 1 October 1974. It was introduced to provide a new code of conduct for the business community, encouraging fair trading at all levels from the manufacturer through to the consumer. It provides for regulation of anti-competitive and misleading or deceptive trading practices, and for protection not only of consumers but of their sources of supply.

The Act is a blend of legal and economic elements; it uses economic terms and calls for analysis of economic processes.¹

The legislation is aimed at providing for three economic objectives, namely:

- (1) industry efficiency and resulting community benefit;
- (2) competition as a means to that end; and
- (3) consumer protection for its own sake and as a stimulus to competition.

Aims (1) and (2) fall in Part IV of the Act, which is discussed in this chapter; Aim (3), covered by Part V, is discussed at ¶7-230ff. The enforcement procedures and defences available under the *Trade Practices Act* are examined at ¶8-750—¶8-930.

¶8-020 Scope of the Act. As noted in Chapter 7 (¶7-220), the operation of the *Trade Practices Act* as a Commonwealth Act has strict constitutional limitations. Briefly, the Act applies to the activities of corporations, and to the business and commercial activities of individuals who engage in interstate, overseas, Australian Capital Territory or Northern Territory trade or commerce or, in relation to consumer protection provisions, use postal, telegraph, radio or telephone services. It applies to professions if within the constitutional formula.

There are a number of sources of immunity from the Act:

- Sections 2A and 2B provide that the *Trade Practices Act* applies to Commonwealth and State/Territory government business activities

1. See Brunt, M, *The use of economic evidence in antitrust litigation: Australia* (1986) 14 ABLR 261; for background see Fleming, G and Terwiel, D, *What effect did early*

Australian antitrust legislation have on firm behaviour? Lessons from business history (1999) 27 ABLR 47. The legislation is modelled on US anti-trust law.

respectively.² Beyond this, the “Shield of the Crown” doctrine gives immunity in limited areas of government activity at State or Territory level.

From 21 July 1996, under the national competition regime (see below), Part IV and related provisions of the *Trade Practices Act* apply to the Crown in right of the States, the Northern Territory and the Australian Capital Territory, so far as it carries on a business, directly or by an authority of the State or Territory. However, the Crown in right of the States and Territories will not be liable to a pecuniary penalty or to be prosecuted for an offence.

- Section 51(1) exempts from Part IV of the Act:
 - anything specified in and specifically authorised by Commonwealth or Territory legislation (other than legislation relating to patents, trade marks, designs or copyright: ¶3-470; ¶3-690);
 - anything specified in and specifically authorised by State or Territory legislation if the State or Territory is party to the Competition Principles Agreement (below).
- Section 51(2) exempts from Part IV (except the secondary boycott provisions (¶8-240) and the resale price maintenance provisions (¶8-440)):
 - matters relating to employment contracts to the extent that they relate to conditions, etc of employees (sec 51(2)(a), (b));
 - standards approved by the Standards Association of Australia (sec 51(2)(c): ¶7-495);
 - certain clauses concerning termination of partnerships (sec 51(2)(d); cf ¶10-490);
 - provisions of a contract to protect the goodwill of the purchaser of a business (sec 51(2)(e)). This preserves those parts of a restraint of trade covenant which would be valid at common law (¶5-840). Hence a restraint which does more than protect the goodwill of the purchaser of a business would lose the protection of sec 51(2)(e).³
 - certain export contracts (sec 51(2)(g)).
- Section 51(3) exempts the following from Part IV (except the secondary boycott provisions (¶8-240) and the resale price maintenance provisions (¶8-440)):
 - certain matters relating to the licensing of patents, registered designs, copyright, EL rights and trade marks (¶3-470; ¶3-690).
- Section 172 provides for exemptions from the Act by the making of Regulations.

2. The facts giving rise to *Bass v Permanent Trustee Company Ltd* (1999) 73 ALJR 522, (1999) ATPR ¶41-682 which held that sec 6(3) and 75B(1) did not apply to a

State government, took place before sec 2B was passed.

3. eg *Peters (WA) Ltd v Petersville Ltd* (1999) ATPR ¶41-714; ¶5-860.

The above exemptions from Part IV of the Act do not provide exemptions from Part V dealing with consumer protection.

National competition regime. Universal and uniformly applied rules of competitive conduct apply from 1996 to all sectors of business in Australia (including State and Territory government businesses, eg electricity, gas and water authorities, and unincorporated businesses operating within a State, eg the professions).

A co-operative Commonwealth, State and Territory legislative scheme, essentially adopting the proposals made by the 1993 Hilmer Report on national competition policy,⁴ was implemented over three stages between 1995 and 1996. This co-operative legislative scheme provides for the application of a modified Part IV of the *Trade Practices Act* by all the States and internal Territories, thus overcoming the constitutional limitations that prevent the Commonwealth from legislating directly (¶7-220).

The centrepiece legislation is the *Competition Policy Reform Act 1995* (Cth),⁵ which makes extensive amendments to the competition provisions of the *Trade Practices Act* and provides the mechanism for the application of Part IV to other jurisdictions by inserting a "personalised" Schedule version of Part IV to include persons as well as corporations (the new Competition Code). The *Competition Policy Reform Act 1995* is complemented by three inter-governmental agreements, the Conduct Code Agreement, the Competition Principles Agreement and the Agreement to Implement the National Competition Policy and Related Reforms.

The first stage of amendments to the *Trade Practices Act* made by the *Competition Policy Reform Act 1995* came into operation in August 1995. These amendments:

- extend the competitive conduct rules to the resupply of services in relation to exclusive dealing (¶8-360) and resale price maintenance (¶8-440);
- provide for authorisation of price fixing for goods and resale price maintenance on public benefit grounds (¶8-630);
- provide for notification of third line forcing where its benefits outweigh its costs (¶8-706);
- repeal prohibition against price discrimination under sec 49;
- introduce the Competition Code (new Part XIA), essentially a modified Schedule version of Part IV (with all the above changes in place) but applying to all persons, including corporations.

4. *Report of the Independent Committee of Inquiry into National Competition Policy* (the Hilmer Report), AGPS, August 1993, noted eg *Forum*, TPC Bulletin No 80, pp 1-18 (February 1995); Marks, D, *Competition Policy Reform Act 1995* —

Applying competition law to the States (1996) 26 QLSJ 27. Specific recommendations are noted at ¶8-440, ¶8-630, ¶8-725.

5. eg Second Reading Speech, Senate, 29 March 1995, p 2434.

The second stage of amendments to the *Trade Practices Act* made by the *Competition Policy Reform Act 1995* came into effect in November 1995. These amendments:

- establish a new regulator, the Australian Competition and Consumer Commission (¶8-725), which is a merger of the Trade Practices Commission and the Prices Surveillance Authority;
- create a new advisory body, the National Competition Council, jointly created by Commonwealth, State and Territory governments to co-ordinate reform;
- rename the Trade Practices Tribunal the Australian Competition Tribunal (¶8-730); and
- establish an access regime to facilitate third parties obtaining access to the services of certain essential facilities of national importance, eg electricity, gas or water.

The third stage of amendments came into operation in July 1996. These amendments:

- removed the shield of the Crown for the States and Territories in so far as the Crown carries on a business;
- at the same time, complementary State and Territory application legislation became operative.⁶

In relation to the inter-governmental Agreements, which were signed by the Commonwealth, States and Territories in April 1995:

- The Conduct Code Agreement sets out the processes for amendments to the competition laws of the Commonwealth, States and Territories and for appointments to the new regulator, the Australian Competition and Consumer Commission.
- The Competition Principles Agreement sets out the arrangements for appointments to, and deciding the work program of, the National Competition Council, and sets out the principles that all the governments have agreed to follow in relation to prices oversight, structural reform of public monopolies, review of anti-competitive legislation and regulations, access to services provided by means of essential facilities, and elimination of net competitive advantages enjoyed by government businesses where they compete with the private sector.

6. *Competition Policy Reform (New South Wales) Act 1995* (NSW); *Competition Policy (Victoria) Act 1995* (Vic); *Competition Policy (Queensland) Act 1996* (Qld); *Competition Policy (Western Australia) Act 1996* (WA); *Competition*

Policy (South Australia) Act 1996 (SA); *Competition Policy (Tasmania) Act 1996* (Tas); *Competition Policy (Australian Capital Territory) Act 1996* (ACT); *Competition Policy (Northern Territory) Act 1996* (NT).

- The Agreement to Implement the National Competition Policy and Related Reforms provides for financial assistance to the States and Territories in return for their continued progress in implementing the new national competition policy and related reforms.

¶8-030 Prohibited restrictive trade practices. Eleven classes of restrictive trade practices are prohibited by Part IV of the *Trade Practices Act*.

Four are prohibited outright (“per se”), without the need to show their effect on competition.

The other seven are prohibited only if they substantially lessen competition:

- (1) agreements affecting competition (horizontal agreements): sec 45(2)(a)(ii), 45(2)(b)(ii)—prohibited if substantially lessen competition (¶8-050);
- (2) horizontal price fixing—prohibited per se: sec 45A (¶8-110);
- (3) covenants running with land—prohibited if substantially lessen competition: sec 45B (¶8-180);
- (4) covenants in relation to prices—prohibited if substantially lessen competition: sec 45C (¶8-190);
- (5) primary boycotts with an exclusionary provision: sec 45(2)(a)(i), 45(2)(b)(i) — prohibited per se (¶8-220);
- (6) secondary boycott—prohibited if substantially lessens competition: sec 45D (¶8-240);
- (7) misuse of market power—prohibited if affects competition: sec 46 (¶8-300);
- (8) exclusive dealing—prohibited if substantially lessens competition: sec 47(1) (¶8-360);
- (9) third line forcing—prohibited per se: sec 47(6), (7) (¶8-410);
- (10) resale price maintenance (vertical price fixing)—prohibited per se: sec 48, 96 (¶8-440);
- (11) mergers—prohibited if substantially lessen competition: sec 50 (¶8-570).

All of these restrictive trade practices—except misuse of market power (sec 46)—can be authorised by the ACCC under one of two tests (see ¶8-630):

1. Does the benefit to the public outweigh the anti-competitive detriment?
or
2. Does the proposed restriction result in a benefit to the public?

The Australian system is one of dual enforcement, involving both court enforcement and the case-by-case administrative procedure of the Australian Competition and Consumer Commission, the ACCC, (formerly the Trade Practices Commission, the TPC) and the Australian Competition

Tribunal (formerly the Trade Practices Tribunal). The Commission has important functions in prosecution, research and information (§7-880; §7-910) and authorisation (§8-620—§8-710), the last of which may be reviewed by the Tribunal (§8-730).

§8-040 Essential concepts: “market” and “competition”.

The economic concepts of “market” and “competition” underlie the operation of the Act. Breach of Part IV depends on the effect of conduct on a “market”, so that market definition is essential. For example, sec 45 deals with agreements substantially lessening “competition”, and competition is defined in sec 45(3) to mean “competition in any market in which [the firm]... supplies or acquires ... goods or services”.

“*Market.*” Identification of the market is the first step in assessment of present competition and the likely competitive effect of any (planned) course of conduct. In other words, “[f]or trade practices adjudication, the market is the network of actual and potential transactions between buyers and sellers of goods or services that are, or could be, in close competition.”⁷

The now classic definition of “market” in trade practices law appears in the *QCMa case*:⁸

“... we should explain our understanding of the market concept ... We take the concept of a market to be basically a very simple idea. A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them. (If there is no close competition there is of course a monopolistic market.) Within the bounds of a market there is substitution — substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. Let us suppose that the price of one supplier goes up. Then on the demand side buyers may switch their patronage from this firm’s product to another or from this geographic source of supply to another. As well, on the supply side, sellers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another. Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance, and cost and price incentives.

It is the possibilities of such substitution which set the limits upon a firm’s ability to ‘give less and charge more’. Accordingly, in determining the outer

7. *Re Media Council of Australia Ltd* (1996) ATPR ¶41-497 at p 42,262.

8. *Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd* (the *QCMa case*) (1976) 25 FLR 169 at p 190; (1976) ATPR ¶40-012 at p 17,247 (the case also provides the classic definition

of “competition” extracted below, and “benefits to the public” extracted at ¶8-630); supported by the High Court in the *Queensland Wire Industries case*, ¶8-300; Marshall, B, *The dilemma of market definition*, Australian Lawyer, Vol 31, No 9, p 7 (October 1996).

boundaries of the market we ask a quite simple but fundamental question: If the firm were to 'give less and charge more' would there be, to put the matter colloquially, much of a reaction? And if so, from whom? In the language of economics the question is this: From which products and which activities could we expect a relatively high demand or supply response to price change, ie, a relatively high cross-elasticity of demand or cross-elasticity of supply?"

The process of defining the market involves isolating a certain set of sales which are likely to be affected by the conduct in question. This should be an objective process based on a consideration of the products, geographical areas, and functional levels involved. If the market has been correctly defined, there should be only one such set of sales, not several possible ones. However, this set of sales need not be observable as one block. It may be made up of a number of smaller pieces or submarkets.

—Case examples—

This can be illustrated by reference to the test in the US *Cellophane case*. The court had to determine whether EI du Pont de Nemours and Company had monopolised trade in cellophane (within the meaning of the *Sherman Antitrust Act 1890* (US) sec 2). The case turned upon whether the relevant market was cellophane or a much broader category of "flexible packaging material". If the market was cellophane, the company had at least 75% of the market; if the market was flexible packaging material, the company had less than 20%. The court majority upheld the latter view — in a decision widely criticised — which meant that there was no monopoly power in the relevant market. Interchangeability of cellophane with other packaging material was the deciding factor.

*United States v EI du Pont de Nemours and Company (the Cellophane case)*⁹ —

The Superleague case. In the Superleague decision at first instance (see *News Ltd v Australian Rugby Football League Ltd* (1996) ATPR ¶41-466), Burchett J concluded that the sports which would attract spectators from rugby league if it were to "give less and charge more" were rugby union, soccer, Australian rules football and basketball. This was the sporting entertainment market, as defined by substitution and competition.

Burchett J's decision was overturned on appeal by the Full Court of the Federal Court of Australia. However, the Full Court did not find it necessary to consider the issue of market definition, because a contravention of the *Trade Practices Act* was found on grounds that did not require the market to be defined (¶18-220).

*News Ltd v Australian Rugby Football League Ltd*¹⁰ —

Structure, conduct and performance. Once the market has been defined, the competition analysis proceeds to evaluate the effect of the activity for which the authorisation is sought on the competitive structure, conduct and performance of the market. Wherever possible, all three of these aspects of competitive effect are looked at, since in any given case the detrimental effects

9. 351 US 377 (1956).

10. (1996) ATPR ¶41-521; ¶18-220, ¶18-300.

of the activity on the comparative structure of the market may be either aggravated or mitigated by the competitive conduct in, and the performance of, the market.

“Competition” in the relevant market. The Act aims to preserve competition and the competitiveness of private enterprise. In economic terms, this means the preservation of rivalry, but when a court or tribunal is confronted with this concept (is this understanding anti-competitive?), legalistic definitions as well as economic evidence must be considered.

The effect of an agreement or conduct on competition must be tested by reference to a market for goods or services.

For the purposes of sec 45, “competition” is defined to mean competition in any market in which a party to the contract, arrangement or understanding supplies or acquires (or is likely to supply or acquire) goods or services (sec 45(3)).

In the *QCMA/Defiance-Barnes case*¹¹ the Tribunal explored some of the connotations of the term “competition”. It said:

“... Competition may be valued for many reasons as serving economic, social and political goals. But in identifying the existence of competition in particular industries or markets, we must focus upon its economic role as a device for controlling the disposition of society’s resources. Thus we think of competition as a mechanism for discovery of market information and for enforcement of business decisions in the light of this information. It is a mechanism, first, for firms discovering the kinds of goods and services the community wants and the manner in which these may be supplied in the cheapest possible way. Prices and profits are the signals which register the play of these forces of demand and supply. At the same time, competition is a mechanism of enforcement: firms disregard these signals at their peril, being fully aware that there are other firms, either currently in existence or as yet unborn, which would be only too willing to encroach upon their market share and ultimately supplant them.

This does not mean that we view competition as a series of passive mechanical responses to ‘impersonal market forces’. There is of course a creative role for firms in devising the new product, the new technology, the more effective service or improved cost efficiency. And there are opportunities and rewards as well as punishments. Competition is a dynamic process; but that process is generated by market pressure from alternative sources of supply and the desire to keep ahead.

... effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.”

11. *Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd* (the *QCMA case*) (1976) 25 FLR 169

at pp 187-188; (1976) ATPR ¶40-012 at pp 17,245, 17,246.

Factors indicating market structure. The Tribunal in the *QCMA case* further said:

“Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate. The elements of market structure which we would stress as needing to be scanned in any case are these:

- (1) the number and size distribution of independent sellers, especially the degree of market concentration;
- (2) the heights of barriers to entry, that is the ease with which new firms may enter and secure a viable market;
- (3) the extent to which the products of the industry are characterized by extreme product differentiation and sales promotion;
- (4) the character of ‘vertical relationships’ with customers and with suppliers and the extent of vertical integration; and
- (5) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities.

Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of the entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct.”

Section 4E provides that, for purposes of the Act, “market” means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are *substitutable* for, or otherwise *competitive* with, the first-mentioned goods or services.

ANTI-COMPETITIVE AGREEMENTS _____

¶8-050 Anti-competitive agreements: sec 45(2)(a)(ii), 45(2)(b)(ii). Section 45(2) prohibits agreements which have the purpose of substantially lessening competition.¹² It creates the two offences of:

- (1) making (sec 45(2)(a)(ii)) *or*
- (2) giving effect to (sec 45(2)(b)(ii))

a contract, arrangement or understanding which has the purpose of substantially lessening competition.

12. Anti-competitive conduct is also regulated by the common law dealing with restraint of trade (¶5-840ff) the operation of which is preserved by sec 4M of the *Trade Practices Act 1974* (Cth)

so far as it is capable of operating concurrently and, in New South Wales, by the *Restraints of Trade Act 1976* (NSW) (¶5-887).

To “*give effect to*” is defined in sec 4 to include doing something pursuant to or in accordance with, or enforcing or purporting to enforce.

The expression “*contract, arrangement or understanding*” is referred to in the two offences in sec 45(2) and in 45A.

“*Contract.*” The Act is directed against “contracts” in the formal sense — ie enforceable contracts as analysed in Chapters 5 and 6 — which lessen competition. But it is also directed at agreements of a lesser kind, namely those which may not be strictly enforceable under ordinary contract law principles. The term “contract” also includes commercial leases and licences of land (sec 4H).

“*Arrangement or understanding.*” An arrangement or understanding requires:¹³

“a meeting of the minds of those said to be parties to the arrangement or understanding. In some cases this may be inferred from circumstantial evidence. There must be a consensus as to what is to be done and not just a mere hope as to what might be done or happen. Independently held beliefs are not enough.”

— *Case example* —

In the *Email case*, parallel pricing engaged in by the only two Australian manufacturers and suppliers of kilowatt-hour meters was found to be explainable on the basis of commercial considerations unconnected with collusion. Attacks by the Trade Practices Commission based on joint action were found to lack substance, and the identical pricing structures of the two companies in question were found to be explainable by the history and the nature of the industry itself. Even evidence of communications between the two companies (on matters other than pricing) was found not to support the charge of an “arrangement” between parties. However, parallel conduct may constitute circumstantial evidence from which an arrangement or understanding may be inferred. The prosecution in this case failed not so much on the law as on the facts.

— *TPC v Email Ltd*¹⁴ —

Section 4F explains that a contract, arrangement or understanding is deemed to have the necessary “**purpose**” if that purpose is a “substantial purpose” of the “contract, arrangement or understanding”.

Section 4G explains that “**lessening**” competition includes “preventing or hindering” competition.

13. *Trade Practices Commission v Email Ltd* (1980) 43 FLR 383 at p 385; (1980) ATPR ¶140-172 at p 42,370.

14. (1980) 43 FLR 383; (1980) ATPR ¶140-172.

Examples of anti-competitive agreements under sec 45(2)(a)(ii) and sec 45(2)(b)(ii) include:¹⁵

- market sharing agreements — which have the purpose or effect of allocating or dividing customers, territories, acquisitions or sales, or markets (geographic or otherwise) for any goods or services. Market sharing is more anti-competitive than price fixing, as it is designed to create an area of monopoly in which competitors, and therefore price competition, are totally absent.
- agreements constituting codes of ethics. “Codes of ethics” may have a proper and non-restrictive function in the regulation of a professional or trading group. Codes may offer advantages for business (such as business guidance, procedures and information) and for consumers (such as improved market information, service and response to consumer complaints). The danger of a code of ethics is that it may be anti-competitive under the Act or a restraint of trade at common law (§15-840ff).
- standard forms of contract and uniform terms of trading. The advantage of these is that they may promote efficiency through minimising negotiations on procedural matters. The disadvantage is that standard forms or terms may impede the competitive process.

— Case examples —

The TPC and the accounting profession. The TPC began a study of competition in the market for professional services in 1990 to detect and expose inefficient and protected business practices. The TPC concluded that, on the whole, regulation of the accounting profession did not excessively hinder competition among members of the accounting bodies, subject to the following areas of concern:

- Advertising. The TPC saw no public interest in current rules which restrict “poaching” of other members’ clients.
- Fees. The accounting bodies’ non-prescriptive fee guidelines on time charging were commended, but the TPC felt they still discouraged innovative pricing such as contingency fees (§17-765).
- Practice entities. The TPC was unsure of the public benefit of the accounting bodies’ prohibition of the description “public accountants” and “accountants” for partnerships with non-members (§10-020).
- Insolvency. The TPC found anti-competitive the limits on who could practise in insolvency (liquidators, who must be accountants: §9-625), the fees charged, and appointment on the current rotation basis in New South Wales, Victoria and Western Australia instead of by market selection (based on matters such as expertise and cost).

— TPC report on the accountancy profession¹⁶ —

15. Restraints of trade may also breach other sections of the TPA such as sec 47(1) (§8-360) and sec 51AA-51AB (unconscionability: §5-756). At common law they may also involve restraint of trade (§15-840) and unconscionability

(§15-730). They may also breach the unconscionability provisions of the consumer credit legislation (§14-240).

16. 22 July 1992, discussed in TPC Bulletin, No 67, p 25 (July-August 1992).

The concrete case. Pioneer Concrete, Boral and CSR were prosecuted for price fixing in breach of sec 45(2)(a)(ii) and sec 45(2)(b)(ii). Penalties under sec 76 of \$6.6m *each* were agreed with the ACCC (¶8-770).

_____ ACCC v Pioneer Concrete (Qld) Pty Ltd¹⁷ _____

The "Coffee Club". Companies and senior management in the Queensland fire protection industry held regular meetings called the "Coffee Club" at which they agreed who would win current tenders and the prices they would submit. Creating a market sharing cartel is price fixing and collusive tendering which breaches sec 45(2)(a)(ii) and 45(2)(b)(ii). On the basis that the purpose of penalties under the Act is deterrence, the court imposed penalties of \$5m on the Tyco group as follows: Wormald Fire Systems (\$1.4m), O'Donnell Griffin (\$3.3m), two senior managers \$100,000 personally and two other senior managers \$50,000 personally (for their lesser culpability). Penalties were imposed on the other parties to the price fixing agreement in later proceedings.

_____ ACCC v Tyco Australia Pty Ltd¹⁸ _____

Pipe fittings and valves. Two companies were fined \$1.75m for breaches of sec 45(2)(a)(i) and (ii) and sec 45(2)(b)(i) and (ii) for price fixing and market sharing arrangements in the market for fittings and valves for use in water supply systems. Penalties were not imposed on senior management personally as they had "shown contrition" for their conduct and had been removed from their positions within the companies. The penalties were less than they might otherwise have been as the companies had co-operated with the ACCC in disclosure and had taken remedial action to remedy the consequences of the breaches. One company agreed to pay compensation of \$1.23m to affected customers.

_____ ACCC v Tubemakers of Australia Ltd¹⁹ _____

Year 2000 compliance. Section 17 of the *Year 2000 Information Disclosure Act 1999* (Cth) (¶5-015) provides that sec 45, which prohibits agreements which have the effect of substantially lessening competition, does not apply to contracts, arrangements and understandings entered into up until 1 July 2001 for disclosure and/or exchange of information on "Y2K" problems, remediation efforts and compliance.

Anti-competitive agreements may be authorised under authorisation "test 1" — whether public benefit outweighs anti-competitive detriment: see ¶8-630, ¶8-660.

PRICE FIXING _____

Contracts, etc in relation to prices: sec 45A ¶8-110

Form of agreement immaterial:

 "recommended retail price" ¶8-120

Exceptions to general price fixing prohibition ¶8-130

17. (1996) ATPR ¶41-457.

18. [1999] FCA 1799; (2000) ATPR ¶41-740, noted ACCC Journal, Issue 25, p 77 (February 2000); [2000] FCA 401; (2000) ATPR ¶41-760.

19. [1999] FCA 1787; (2000) ATPR ¶41-745, noted ACCC Journal, Issue 25, p 78 (February 2000); further penalties in [2000] FCA 227 (unreported) and in *ACCC v Geoff Clegg Enterprises Pty Ltd* [2000] FCA 977; (2000) ATPR ¶41-773.

¶8-110 Contracts, etc in relation to prices: sec 45A.

Price fixing, which lies at the very heart of anti-competitive behaviour, is made illegal under sec 45A. Section 45A(1) provides that a contract, arrangement or understanding (or one proposed) between parties in competition with each other is per se illegal if the provision has the purpose, or has or is likely to have the effect of fixing, controlling or maintaining (or providing for the fixing, controlling or maintaining) of the price for (or a discount allowance, rebate or credit in relation to) goods or services. These agreements are deemed to have an anti-competitive effect.

What is price fixing? Prices are “fixed because they are agreed upon”, said the US Supreme Court.²⁰ Prices are unlawfully fixed if a range within which purchases or sales will be made is agreed upon, if the prices charged or paid are to be at a certain level or on an ascending or descending scale, if they are to be uniform, or if by various formulae they are related to the market price. Thus the fact that a rigid price is not fixed is irrelevant. Also the fact that the prices fixed are reasonable or fair, or are not raised and maintained at high, arbitrary and non-competitive levels, is irrelevant. Moreover, the method by which prices are fixed is immaterial. Any combinations which tamper with the price structure are engaged in unlawful activity.

— Case examples —

In the leading US case on this point, it was said that whether a price fixing restraint is or is not reasonable is not the point: at issue is its effect on competition. This area of law was said to be based on the assumption that “the public interest is best protected from the evils of monopoly and price control by the maintenance of competition”.

— *United States v Trenton Potteries Co*²¹ —

“Orderly marketing” by freight companies. The three major companies in the freight industry (TNT, its half-owned subsidiary Ansett, and Mayne Nickless), accounting for 90% of all sales, agreed to fix prices and not to compete with each other. There was evidence that they agreed not to poach each other’s customers and to compensate each other if customers changed companies. These cartel-style operations squeezed small independent carriers who found it difficult to enter the freight industry. The TPC’s action under sec 45 for price fixing came to an end when the three companies withdrew their defences. Having spent \$4.7m on legal costs to date, and without admitting liability, the companies chose to avoid the further costs of continuing to defend the matter. For alleged price fixing, the Federal Court imposed pecuniary penalties totalling \$4.1 on TNT, \$900,000 on Ansett, \$6m on Mayne Nickless and a total of \$815,000 on 15 senior executives of the respective companies, including a pecuniary penalty of \$75,000 on the former general manager of TNT. TNT and Ansett agreed to pay \$1.075m in costs, and Mayne Nickless agreed to pay \$1.3m.

— *TPC v TNT Pty Ltd*²² —

20. *US v Socony-Vacuum Oil Co* 310 US 150, 60 S Ct 811 (1940).

22. (1995) ATPR ¶41-375. (The parties negotiated the penalties: ¶8-770.)

21. 273 US 392 (1927).

Three companies (and their managers or directors) which supplied frozen foods to retailers admitted to charges of price fixing laid by the ACCC. The ACCC negotiated a penalty with the companies, and the parties submitted agreed penalties to the court including a penalty of \$900,000 under sec 76 for the first company.

*ACCC v NW Frozen Foods Pty Ltd*²³ —

When Tip Top Bakeries stopped supplying two retailers because they discounted Tip Top Bread, Tip Top was fined \$1.25m for price fixing under sec 45A and for resale price maintenance under sec 48 (¶8-440).

*George Weston Foods Ltd (trading as Tip Top Bakeries)*²⁴ —

REIWA. Under a licensing agreement, the REIWA agreed to provide certain copyright materials for real estate training courses to two TAFE colleges in consideration of the colleges agreeing to fix a minimum course price equal to the price at which the REIWA offered the course.

The ACCC settled its prosecution of the REIWA for anti-competitive conduct in breach of the TPA by:

- the REIWA and its Executive Director admitting that its licensing agreement with two TAFE colleges breached the price fixing prohibition in sec 45A and 45(2)(a)(ii);
- the REIWA and its Executive Director admitting that certain membership rules were anti-competitive and in breach of sec 45(2)(a)(i) and (ii) and sec 45(2)(b)(i) and (ii) of the Act;
- the solicitor for REIWA admitting that he was knowingly concerned in a breach of the Act when he prepared the illegal copyright licence agreements with the TAFE colleges;
- the TAFE colleges providing undertakings to the Court not to enter into agreements fixing the prices of training services in the future;
- the REIWA agreeing to publish a corrective notice setting out this outcome (under sec 80: ¶8-830) as deterrent publicity; and
- the REIWA agreeing to implement a trade practices compliance program for six years.

As a result of the settlement, real estate agents in Western Australia will be free to compete more actively, to approach non-clients, to offer consumer incentives and to decide whether or not they wish to be or to remain members of the REIWA.

*ACCC v Real Estate Institute of Western Australia*²⁵ —

J McPhee, an express freight carrier, was fined \$2m and four of its senior officers were fined between \$45,000 and \$80,000 personally for making or

23. (1996) ATPR ¶41-515: the judge raised the first penalty to \$1.2m, but this was reduced in *NW Frozen Foods Pty Ltd v ACCC* (1997) ATPR ¶41-546 to \$900,000, noted in ACCC Journal, Issue 7, p 5 (February 1997).

24. Also *ACCC v Australian Safeway Stores Pty Ltd* (1997) ATPR ¶41-562; noted ACCC Journal, Issue 9, p 25 (June 1997).

25. (1999) ATPR ¶41-673; (1999) ATPR ¶41-719, noted ACCC Journal, Issue 24, p 62 (December 1999); ¶8-830.

attempting to make an arrangement or to reach an understanding regarding prices with DFI, a competitor, regarding two clients, Just Jeans and ACI.

_____ *J McPhee & Son (Aust) Pty Ltd v ACCC*²⁶ _____

Price leadership. Does the law reach a situation where sellers follow the prices of the industry leader? US cases are to the effect that price leadership without more is not itself a violation of the law. It was held that “the fact that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer, does not establish any suppression of competition or show any sinister domination”. Also it was held that the voluntary adoption of a competitor’s price is not unlawful.²⁷

Parallel pricing. The *Email case*, noted at ¶8-050, indicates that parallel pricing engaged in by the only two Australian manufacturers and suppliers of kilowatt-hour meters was found to be explicable on bases other than those of an anti-competitive agreement.

Price of standardised product. Proof of price uniformity in the sale of a standardised commodity with or without price leadership is not sufficient to make a prima facie showing of an agreement to fix prices. The similarity of prices in the sale of a standard product such as structural steel would not by itself present a prima facie case of collusive price fixing by steel producers. Competition will normally cause one producer to charge about the same price as is charged by other producers (¶8-040).

¶8-120 Form of agreement immaterial: “recommended retail price”. The prohibition of price fixing is directed to the substance, not the form, of the agreement. A price fixing agreement is unlawful regardless of its form or the description that has been given to it (sec 45A(5)). An agreement called by the parties “recommended prices only” would be covered by the sec 45A prohibition if the agreement has in fact the purpose or effect (or the likely effect) of fixing, controlling or maintaining the prices of goods or services (sec 45A(6)); (cf sec 97: ¶8-470).

Recommended resale price agreements prohibited. Included within sec 45A prohibitions are agreements between a number of competitive suppliers whereby it is agreed that specific resale prices will be recommended by each of them to resuppliers of their goods or services (sec 45A(7)).

Horizontal recommended prices and costing assistance. Horizontal price recommendations such as “recommended prices” breach the Act if they really mean price fixing. They do not if they are part of a joint promotion arrangement with a pro-competitive thrust.

26. [2000] FCA 365; (2000) ATPR ¶41-758 (breaches of sec 4D and 45A(1)), noted ACCC Journal, Issue 27, p 30 (June 2000).

27. *US v International Harvester Co* 274 US 693, 47 S Ct 748 (1927).

¶8-130 Exceptions to general price fixing prohibition. The absolute prohibition of price fixing does not apply to:

- agreements between the parties to a joint venture relating to the selling price of joint venture goods or services where the product is jointly supplied by two or more parties to the joint venture or by all the joint venture parties in proportion to their respective interests (sec 45A(2));
- agreements on the price for goods and services to be paid by a collective buying group, or agreements relating to the price at which the members of such a buying group will jointly advertise the resupply of goods or services (sec 45A(4)).

COVENANTS AFFECTING LAND AND PRICES _____

Covenants affecting competition: sec 45B¶8-180
Covenants in relation to prices: sec 45C¶8-190

¶8-180 Covenants affecting competition: sec 45B. A covenant is an agreement creating a positive obligation (to do something) or a negative obligation (not to do something). A covenant running with land, including a covenant in a lease (¶3-760),²⁸ is unenforceable if it has the effect of substantially lessening competition. (It is not prohibited outright (“per se”): ¶8-030.) Section 45B would make the following unenforceable.

— Examples of covenants affecting land — _____

A condition in a lease where the lessor of a shopping centre agrees not to issue another lease in the shopping centre for the sale of widgets.

Vendor sells two adjoining blocks of land to different purchasers. It sells Lot 1 as a site for a hotel. It sells Lot 2 as a site for a shopping centre, with a covenant that the purchaser will not apply for a liquor licence to set up a hotel. This restriction on the rights of the owner of Lot 2 would breach sec 45B.²⁹

28. But not a covenant which amounts to exclusive dealing (¶8-360) or third line forcing (¶8-410): sec 45B(5).
29. These are the facts of *Quadramain Pty Ltd v Sevastapol Investments Pty Ltd*

(1976) 133 CLR 390, in which the High Court put form over substance and held that the TPA as it then read did not apply to an interest in land. Sec 45B and 45C were added to the Act in 1977 to overcome this decision.

Section 45B protects residential interests as it does not apply if the “sole or principal purpose” for which the covenant was or is required to be given was or is to prevent the relevant land from being used otherwise than for residential purposes (sec 45B(9)(a)). Covenants protecting residential interests are therefore enforceable.

Section 45B does not apply to covenants which are required for the purposes of religious, charitable or public benevolent institutions (sec 45B(9)(b), 45B(9)(c)).

Covenants affecting competition may be authorised if public benefit outweighs anti-competitive detriment: ¶8-630.

¶8-190 Covenants in relation to prices: sec 45C. A restrictive covenant designed to fix, control or maintain prices of goods or services is unenforceable under sec 45C if it has the effect of substantially lessening competition. (Section 45C does not make covenants unenforceable outright (“per se”) — regardless of their competitive effect.)

Price fixing between competitors is the classic restrictive trade practice, and sec 45C is designed to catch practices which produce the same effect as price fixing even if not formally described as such.

Covenants in relation to prices may be authorised under authorisation “test 1” if public benefit outweighs anti-competitive detriment (see ¶8-630).

PRIMARY BOYCOTTS

¶8-220 Exclusionary provisions: sec 45(2)(a)(i), 45(2)(b)(i)/4D. Primary boycotts (also called collective or group boycotts, called in sec 4D of the *Trade Practices Act* “exclusionary provisions”) are prohibited outright (“per se”) under the Act regardless of their effect on competition. The Act prohibits making (sec 45(2)(a)(i)) or giving effect to (sec 45(2)(a)(ii)) a contract, arrangement or understanding (¶8-050) which contains an exclusionary provision.

Essentially, the legislation blocks—

- (a) contracts, arrangements or understandings between persons who are competitive with each other; and
- (b) where the provision has the purpose of preventing, restricting or limiting (with or without particular conditions)
 - the supply of goods or services,
 - the acquisition of goods or services from or by the parties to the contract, etc.

The definition of “services” in sec 4 is very wide (¶7-290), but it does not include the supply of goods or work as an employee “under a contract of service” (¶11-020).³⁰

The classic primary boycott is where competitors A and B agree to protect themselves by targeting C who is seeking to compete. Tactics of A and B may include inducing suppliers not to supply, or inducing customers not to buy from, would-be competitor C.

Examples of exclusionary provisions include:

- two or more competing suppliers who agree not to supply, or only to supply on certain terms, would-be competitor C;
- competitors who divide the market, with agreed shares to each, and
- trade association members who act together to limit or control access to competitors.

— Case examples —

The rodeo case. As members of the Australian Rough Riders Association Inc (ARRA), Neville McCarthy and three colleagues, professional rough riders and rodeo contestants, were restrained on fear of fine and suspension by Rule 13.1 of the Association: “Unaffiliated rodeos: No full member of the [ARRA], financial or not, shall compete at any unaffiliated rodeo ... Fines to be paid into the office of the Association at Warwick before a member competes again.” The effect of the rule was to close the other two main rodeo circuits in the area to them. The rule had long been contentious, and after disobeying it, joining the other two circuits and taking part in their rodeos, McCarthy and colleagues were in effect excluded from many of the best rodeos. McCarthy himself was fined \$3,000 and placed on a good behaviour bond. In preliminary proceedings under the Act, McCarthy and his colleagues’ challenge was upheld pending trial (or settlement), the Federal Court holding that the giving effect to Rule 13.1—

- (1) by the ARRA involved a contravention of sec 45(2)(b)(i);
- (2) by an associated rodeo was evidence that it was party to an exclusionary provision within the meaning of sec 4D(1)(b)(i), contrary to sec 45(2)(a)(i), and that it was a party which in giving effect to Rule 13.1 was in breach of sec 45(2)(b)(i).

Until trial, the offending anti-competitive sentences of Rule 13.1 (quoted above) were held unenforceable.

*McCarthy v Australian Rough Riders Association Inc*³¹ —

The Superleague case. At first instance, News Ltd failed in its application to have “Commitment” and “Loyalty” agreements between the League and 20 rugby league clubs declared void under:

30. Such as footballer contracts: *Adamson v New South Wales Rugby League Ltd* (1991) 31 FCR 242; (1991) ATPR ¶41-141; ¶5-850.

31. (1988) ATPR ¶40-836, noted at (1988) 16 ABLR 258.

- (1) sec 45(2)(b)(i)/4D. There was no breach of sec 4D(1)(a) because the agreements were not between parties competing to supply services to, or to acquire services from, the League. The agreements were vertical, and outside the scope of sec 4D. Indeed, the purpose of the agreements was to preserve the existing Rugby League "National Competition" from Rupert Murdoch's Superleague, and there was no evidence of an improper purpose under sec 4D(1)(b).
- (2) sec 46. Because of the wide definition of "market" (§8-040), there was no evidence of misuse of market power by the League (§8-300).

On appeal to the Full Court of the Federal Court of Australia, the decision of the trial judge was overturned.

In relation to the question of exclusionary provisions, the Full Court held that the "Commitment" and "Loyalty" agreements did contain exclusionary provisions (within the meaning of that term as defined by sec 4D of the *Trade Practices Act*) and were therefore void. These agreements, which were made between the rugby league clubs and the New South Wales Rugby League ("the League") and the Australian Rugby League ("the ARL"), effectively prevented the clubs from playing in a competition not sanctioned by the League or the ARL for a five-year period. The Full Court held that these agreements were made between "competitors", because the facts indicated that, at the time these agreements were executed, the clubs did compete:

- for the services of competition organisers; and
- in relation to the acquisition of the services of premier players.

The correct inference to be drawn from the facts was that there was an arrangement, contract or understanding between the clubs, the League and the ARL to take concerted action to adopt the agreements. Further, this arrangement had a sufficiently substantial exclusionary purpose to satisfy the requirements of sec 4D(2), because the very point of the agreements was to prevent the supply of rugby league teams to any "unauthorised" competition organiser and to prevent the clubs from acquiring the services of any "unauthorised" competition organiser. In essence, therefore, the making of these agreements was found to have contravened sec 45(2)(a)(i) of the TPA, and sec 45(2)(b)(i) prohibited the parties to the agreements from giving effect to the agreements.

The Full Court did not find it necessary to consider the allegations of a misuse of market power in breach of sec 46 (§8-300), because the clubs, the League and the ARL were already found to have contravened sec 45(2) for the reasons outlined above. Even if there had been a misuse of market power, this would not have changed the result of the case.

_____ *News Ltd v Australian Rugby Football League Ltd*³² _____

32. (1996) ATPR ¶41-521 (Full Federal Court); ¶8-040. Following this case, the ARL and the Superleague merged to form the NRL, to consist of 14 clubs. The "Rabbitohs" were unsuccessful in their

attempt to be included in the NRL competition in 2000: *South Sydney District Rugby League Football Club Ltd v News Ltd* [1999] FCA 1710; (1999) ATPR ¶41-727. See also [2000] FCA 1541.

Gatorade v All Sport. P, the owner of the rights in the sports drink “Gatorade”, licensed D (Pepsi) in 1993 to manufacture and distribute Gatorade in Australia and New Zealand. (Before 1993, Gatorade was imported.) When P terminated the licence agreement in 1998, P was successful in restraining D from marketing a competing sports drink called “All Sport”.

D was unsuccessful in its challenge of the restrictive covenant in the licence agreement as an exclusionary provision under sec 4D as:

- its purpose was to protect P’s property, and it was not “preventing, restricting or limiting” (sec 4D(1)(b)) D from competing with P; and
- at the time of the agreement, P and D were not “likely” (sec 4D(2)) to be in competition with each other in respect of sports drinks.

As P had provided all its confidential information to D, the restraint was also valid at common law as there was nothing in the length of time which would be an unreasonable restraint of trade (¶5-840).

— *Stokely-Van Camp, Inc v New Generation Beverages Pty Ltd*³³ —

This prohibition is an outright prohibition, and it applies whether or not competition is affected even though a boycott is not of itself anti-competitive.³⁴

A primary boycott may be authorised under “test 2” — does public benefit justify authorisation? (see ¶8-630).

SECONDARY BOYCOTTS

Secondary boycotts: sec 45D, DA, DB, DC, DD, 45E ¶8-240
Operation of the “secondary boycott” section ¶8-250

¶8-240 Secondary boycotts: sec 45D, DA, DB, DC, DD, 45E. A secondary boycott refers to concerted action by A and B, who engage in conduct which hinders C, to prevent C from supplying, acquiring from or otherwise dealing with D (the “target”). The boycott by A and B is not “primary” (¶8-220) but is “secondary” in that A and B’s action is directed not at C but at D. For the section to operate, however, there must be a third person C who is prevented or hindered from supplying to or acquiring from D: a spontaneous decision by C so to act is outside sec 45D.

Secondary boycotts are not prohibited outright (“per se”), and are only prohibited if they cause substantial loss or damage, substantially lessen competition, or affect trade or commerce. Boycotts are permitted if the dominant purpose of the conduct relates to employment matters, or environmental or consumer protection.³⁵

33. (1998) ATPR ¶41-657.

34. Posner, RA, *Antitrust Law: an Economic Perspective*, University of Chicago Press, 1976, pp 207-208.

35. Section 45D was confined to non-industrial or corporate boycotts, and

industrial relations secondary boycotts were transferred to the *Workplace Relations Act 1996* (Cth) in 1994. The former secondary boycott provisions were reinstated in the TPA in 1997.

Secondary boycotts may be authorised under authorisation “test 2” — does public benefit justify authorisation? (§8-630).

§8-250 Operation of the “secondary boycott” section.

Some changes have been made to the structure of the former secondary boycott sections by separating the various combinations of contraventions which were previously incorporated into the two sections:

- Section 45D deals with secondary boycotts that have the purpose of causing substantial loss or damage. The section prohibits two persons from acting in concert to hinder or prevent a third person trading with a fourth person (the target) where the purpose and effect (or likely effect) of the conduct is to cause substantial loss or damage to the target.
- Section 45DA deals with secondary boycotts that have the purpose of causing substantial lessening of competition. The section prohibits two persons from acting in concert to hinder or prevent a third person trading with a fourth person (the target) where the purpose and effect (or likely effect) of the conduct is to cause a substantial lessening of competition in any market in which the fourth person supplies or acquires goods or services.
- Section 45DB deals with boycotts affecting trade or commerce. The section prohibits two persons from acting in concert where the purpose and effect (or likely effect) of the conduct is to prevent or substantially hinder a third person (the target) engaging in territorial, interstate or overseas trade or commerce.
- Section 45DC deals with the involvement and liability of employee organisations. Section 45DC(1) lists certain situations in which a union is presumed to engage in boycott conduct. Sections 45DC(2)-45DC(5) provide that if a union contravenes sec 45D, 45DA or 45DB, or is presumed to have contravened those sections, it will be liable for any loss or damage suffered by a person as a result of the conduct.
- Section 45DD deals with situations in which boycotts are permitted. Sections 45DD(1), (2) and (3) provide that there is no contravention of sec 45D(1), 45DA(1) or 45DB(1) where the dominant purpose of the conduct substantially relates to employment matters or environmental or consumer protection.
- Section 45E deals with prohibition of contracts, arrangements or understandings affecting the supply or acquisition of goods or services. Section 45DE prohibits a person from making an agreement with a union for the purposes of preventing or hindering trade between that person and another person (the target). It is directed at situations where a person capitulates in order to avoid loss or damage as a result of threatened industrial action against the target.
- Section 45EA deals with not giving effect to provisions contravening sec 45E. Section 45EA prohibits giving effect to a contract, arrangement

or understanding containing a provision which would contravene sec 45E, regardless of whether the contract, arrangement or understanding was made before the commencement of sec 45E.

- Section 45EB deals with sec 45D to 45EA not affecting the operation of other provisions of Part IV of the *Trade Practices Act*. Given the potential overlap between the new boycott provisions and other provisions of Part IV, sec 45EB ensures that nothing in the new provisions affects the operation of any other provision of Part IV.

To reflect the national competition policy reforms, these provisions are also incorporated into the Competition Code text, which consists of a modified or personalised version of Part IV (found in the Schedule to the Act) and all the provisions that relate to the Part IV rules (§8-020).

The former TPC had been reluctant to become involved in sec 45D proceedings before the 1994 amendments, on the basis that such action was better left to private litigants and/or industrial action. The former sec 45D and 45E were used to their full extent in the following cases:

— *Case examples* —

Pre-1994 industrial dispute. Mudginberri's major business was exporting meat. As a result of a dispute between the Australasian Meat Industry Employees Union and Mudginberri, the AMIEU set up a picket line. Members of the Meat Inspectors Association refused to cross this picket to inspect the meat, and Mudginberri suffered substantial losses. Mudginberri sought an interlocutory injunction in the Federal Court on the basis that the AMIEU had allegedly engaged in a secondary boycott in contravention of former sec 45D of the *Trade Practices Act*. This was granted.

In later proceedings the Federal Court fined the AMIEU \$10,000 for disobeying the injunction, and imposed a daily fine of \$2,000 for as long as the picket was maintained. In other proceedings a permanent injunction was granted and a writ of sequestration issued against the union. The union was subsequently ordered to pay damages totalling \$1,759,444 to Mudginberri for loss sustained to its business by reason of the AMIEU's picket. This was the first time major secondary boycott damages had been awarded to an employer against a union because of a picket pursued in breach of former sec 45D of the *Trade Practices Act*.

On appeal, a majority of the High Court held that the imposition of a daily fine for a continuous contempt was within the range of remedies available to the Federal Court and that there was no good reason in appropriate circumstances to deny a court access to such a means of bringing a contempt to an end.

— *The Australasian Meat Industry Employees' Union & Ors v Mudginberri Station Pty Ltd*³⁶ —

Pre-1994 non-industrial boycott: the milk war. New South Wales milk vendors boycotted Jewel stores and refused supply of milk because of Jewel's

36. (1986) 161 CLR 98; (1986) ATPR ¶40-715.

purchase of cheaper milk from Victorian milk suppliers. This boycott by the NSW vendors did not amount to a primary boycott under sec 4D/45(2) because, under the NSW regulatory scheme, the milk vendors were not in competition with each other. The boycott by the NSW vendors ("a person") and the other vendors and their association ("a second person") also did not constitute "a collective secondary boycott" because it did not hinder the acquisition of milk by Jewel customers (the "third person") from Jewel stores (the "fourth person") within former sec 45D(1). Because Jewel's customers were not actually prevented from acquiring goods from Jewel (even though there was no milk in stock), Jewel's case under former sec 45D failed. However, if the case could have been argued on the basis that the Victorian milk suppliers had been targeted by the NSW milk vendors, the result might have been different.

*Devenish v Jewel Food Stores Pty Ltd*³⁷ —

Pre-1994 non-industrial boycott: lorry owner/drivers. When Pioneer sought to reduce the size of its independent lorry owner/driver ("LOD") fleet to nil, the LODs unsuccessfully sued Pioneer under estoppel, unconscionability and misleading or deceptive conduct under the *Trade Practices Act* sec 52 (¶7-250ff). In reply, Pioneer was successful in its cross-claim against the LODs on the basis that their actions of (1) maintaining static truck numbers (by refusing to permit an increase or decrease except on their terms) and (2) of rostering off trucks at such times as the LODs wished, as part of an equalisation scheme, contravened sec 45(2)(a)(i) and (ii) and 45(2)(b)(i) and (ii) and former sec 45D(1)(a)(i)(B) and 45D(1)(b)(ii).

*Gallagher v Pioneer Concrete (NSW) Pty Ltd*³⁸ —

MISUSE OF MARKET POWER

¶8-300 Misuse of market power: sec 46. Section 46 prohibits an abuse of market power where any corporation — big or small — possessing "a substantial degree of power in a market" takes advantage of that power for one of the predatory purposes specified in sec 46(1). Misuse of market power is not an outright prohibition (a "per se" offence), and is assessed by its effect on competition.

Section 46(1) provides:

"A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of—

- (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
- (b) preventing the entry of a person into that or any other market; or
- (c) deterring or preventing a person from engaging in competitive conduct in that or any other market."

37. (1991) 172 CLR 32; (1991) ATPR ¶41-098.

38. (1993) ATPR ¶41-216; appeal dismissed: noted (1994) 68 ALJ 533.

Conduct which could be in breach of sec 46 includes price discrimination, refusal to supply, and predatory pricing if within the language of sec 46(1)(a), (b) or (c).

To prove conduct breaching sec 46, a plaintiff must prove that:³⁹

(1) *the defendant is a corporation within the extended meaning in the Act* (or that any of the other constitutional connections are satisfied — ¶7-220).

(2) *the defendant is a supplier of goods or services in a market for those goods or services* (¶8-040).

(3) *the defendant possesses a substantial degree of power in that market*. The threshold test may be invoked in relation to a corporation that has a lesser degree of market power than that required under the previous sec 46. The former section was entitled “monopolization”, and caught a corporation “being in a position substantially to control a market”. The expression “power” appearing in sec 46(1) is stated to be synonymous with “market power” (sec 46(4)), an established economic concept which is sought to be measured by sec 46(3):

“In determining for the purposes of this section the degree of power that a body corporate or bodies corporate has or have in a market, the Court shall have regard to the extent to which the conduct of the body corporate or of any of those bodies corporate in that market is constrained by the conduct of—

- (a) competitors, or potential competitors, of the body corporate or of any of those bodies corporate in that market; or
- (b) persons to whom or from whom the body corporate or any of those bodies corporate supplies or acquires goods or services in that market.”

Numerous circumstances give rise to absence of competitive restraint, including size or market share in relation to competitors, and/or these factors combined with technical knowledge, raw materials or capital. Matters such as easier access to supplies or government controls on the market may be relevant. More than one corporation may have a “substantial degree of power” in a particular market.

(4) *the plaintiff is a competitor of the defendant in that market or in any other market* (¶8-040), and

(5) *the defendant has taken advantage of that power for the purpose of—*

- (a) *preventing the entry of the plaintiff into that, or any other market, or*
- (b) *detrerring or preventing the plaintiff from engaging in competitive conduct in that, or any other, market.*

To “take advantage of ... power” has no moral or pejorative connotation, and requires no hostile intention:⁴⁰ “The question is simply whether a firm

39. The approach of *French J*, in *OD Transport Pty Ltd v Western Australian Government Railways Commission* (1987) 13 FCR 270 at p 279; (1987) ATPR ¶40-761 at p 48,247.

40. *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd* (1988-1989) 167 CLR 177 at p 191; (1989) ATPR ¶40-925 at p 50,010; (1989) 63 ALJR 181 at p 186.

with a substantial degree of market power has used that power for a purpose proscribed in the section, thereby undermining competition, and the addition of a hostile intent inquiry would be superfluous and confusing.”

This does not therefore mean that any refusal to deal by such a corporation would be a likely breach of sec 46, unless the refusal had the proscribed purpose. In the *Y-bar case*, the High Court confirmed that sec 46 is designed to protect consumers by upholding a free market, and is only designed to prohibit the conduct set out in sec 46(1)(a), (b) or (c) which threatens the competitive process. Therefore the distinction between taking advantage of a substantial degree of power in a market (breaching sec 46) and taking advantage of one’s legal or contractual rights (originally held not to breach sec 46) should now be abandoned.

The former TPC (now ACCC) released its Misuse of Market Power Guideline and Background Paper in 1990 to set out steps that it would follow in assessing whether a corporation has engaged in conduct breaching sec 46.⁴¹ The first steps relate to the threshold test of whether the corporation has a substantial degree of power in a market (cf ¶8-040):

- The “provisional market boundary” is made up of the product market (the product or products making up the dispute), the geographic market (the area in which the corporation distributes or supplies), and the functional level (the level at which the corporation operates — manufacturing, wholesaling or retailing).
- The ACCC will then investigate whether this provisional market is really self-contained or whether the market boundaries can be extended as part of a larger market: if there is a small increase in the price, is there demand substitutability and supply substitutability? If so, the boundaries of the market should be expanded. Alternatively, an analysis of the nature and the extent of competitive constraints operating on the corporation is required. The countervailing power of large buyers is another constraint on market power to be considered.

The ACCC has stated that it will take the following considerations into account in determining if the corporation has misused its market power:

- whether the conduct adversely affects the competitive process in a market;
- whether the conduct adversely affects consumers or users of the goods or services in terms of price, quality, availability, choice or convenience and whether it has impaired competition in an unnecessarily restrictive way;
- whether the conduct raises the costs of entry to a market or prevents or hinders potential competitors from entering the market or from growing; or

41. Trade Practices Commission, *Misuse of market power — guideline on section 46*

of the Trade Practices Act, 13 February 1990.

- whether the conduct can be explained by a good business justification such as efficiency, or the desire to engage in genuine competitive rivalry.

The ACCC's "black list" in the Guidelines of conduct that is generally restrictive of competition includes:

- predatory pricing;
- exclusive dealing arrangements and requirements contracts;
- withdrawal of supply to customers who deal with competitors or who fail to follow price guidelines;
- inducing price discrimination and loyalty rebates;
- tie-ins and similar practices;
- "lease only" policies.

The ACCC's "grey list" of conduct that may be restrictive of competition includes:

- refusal to deal in the context of selective distribution agreements;
- vertical integration resulting in price or supply "squeeze";
- intellectual property licensing arrangements;
- raising rivals' costs and strategic creation of entry barriers;
- denial of access to essential facilities;
- refusal to deal or failure to allow reasonable access to spare parts, manuals, etc.

The ACCC's "white list" of conduct that is not generally restrictive of competition includes:

- research and development leading to the introduction of a new product;
- refusal to license intellectual property rights or disclose confidential information.

— *Case examples* —

The Y-bar/BHP case (1989). BHP was responsible in 1989 for about 97% of Australia's steel output and for filling about 85% of Australia's demand for steel. Since the 1920s it has manufactured (through a subsidiary) Y-bar, a product not for general sale. (BHP's only substantial domestic competitor is Smorgon Consolidated Industries Pty Ltd, which did not at the time supply Y-bar (although it does now.)) Cut into fence post lengths, drilled for wire, with one end sharpened to a point for hammering into the ground, Y-bar with wire becomes Australia's most popular rural fencing, "star picket posts" for star picket fencing.

Based in Brisbane, Queensland Wire Industries Pty Ltd (QWI) began operations in the mid-1960s producing barbed wire, later moving into rural fencing. With Y-bar, QWI would be able to make fencing at a more competitive price than BHP. BHP's response was either to refuse to supply Y-bar, or to offer it at an uncompetitive price to preserve its business of manufacture and wholesale of the fence posts.

QWI claimed BHP had violated sec 46 by refusing to sell it Y-bar. At first instance, the Federal Court held that refusal by BHP to supply to a competitor a product which it had not previously sold, and which it wished to keep for further processing into star picket fencing, did not constitute "taking advantage" of its substantial degree of power in the market.⁴² Certainly BHP's high price for Y-bar could be interpreted as constructive refusal to supply. On appeal, the Full Federal Court held that although BHP might be described as a monopolist in relation to the manufacture and subsequent use of the Y-bar in the production of star picket fence posts, there had never been a market for Y-bar in Australia (as required by sec 4E) so as to attract sec 46. Therefore, there was no evidence of breach of sec 46.⁴³

QWI's claim against BHP succeeded in the High Court. In effectively refusing to supply Y-bar to QWI, BHP had taken advantage of its substantial market power for the purpose of preventing QWI's entry into the star picket fence posts market, in breach of sec 46(1)(b). It also violated sec 46(1)(c), as the purpose of BHP's refusal was that of "detrerring or preventing [QWI] from engaging in competitive conduct" in the market (ie the market for metal post and wire fences, or the market for rural fencing).

The High Court emphasised supply substitutability as an element of the definition of market.

"In effectively refusing to supply Y-bar to the appellant, BHP is taking advantage of its substantial market power. It is only by virtue of its control of the market and the absence of other suppliers that BHP can afford, in a commercial sense, to withhold Y-bar from the appellant. If BHP lacked that market power — in other words, if it were operating in a competitive market — it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor."

*Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd*⁴⁴ —

Phone books. When Telecom entered new contracts with its existing printers for the printing of telephone directories, a smaller printer, passed over by Telecom, failed in actions under sec 46 and 52 (¶17-280). Certainly Telecom had substantial power in the directories market, but its requirements that the printers' printing presses be dedicated to Telecom work only (so that they could not contract to any possible phone book competitor) and its not calling for tenders were designed to meet competition and to improve its competitive edge by upgrading its product and were not in breach of sec 46.

*General Newspapers Pty Ltd v Telstra Corporation*⁴⁵ —

42. *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd* (1987) 16 FCR 50; (1987) ATPR ¶40-810; noted (1988) 16 ABLR 79.

43. *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Co Ltd* (1987) 17 FCR 211; (1988) ATPR ¶40-841.

44. (1988-1989) 167 CLR 177 at p 192; (1989) ATPR ¶40-925 at p 50,010, noted (1989) 63 ALJ 305, 438; (1989) 19 QLSJ 131. See further Pengilly, W, *Misuse of market power: present difficulties — future problems* (1994) 2 TPLJ 27.

45. (1993) 45 FCR 164; (1993) ATPR ¶41-274.

The lessee and occupier of land did not take advantage of its market power under sec 46 when it terminated the rights of a licensee at will in respect of that land.

_____ *Helicruise Air Services Pty Ltd v Rotorway Australia Pty Ltd*⁴⁶ —

The Superleague case. At first instance, *Burchett J* decided that, because the market comprised the sporting entertainment market of rugby union, Australian rules football and basketball, there was no evidence that the Australian Rugby League had any power in this market. The Rugby League's loyalty contracts did not breach sec 46.

Although the Full Court of the Federal Court of Australia did overturn *Burchett J*'s decision, it did not find it necessary to consider the issue of whether there had been a misuse of market power in breach of sec 46 as it found that a breach of sec 45(2) had occurred (see ¶8-220).

_____ *News Ltd v Australian Rugby Football League Ltd*⁴⁷ —

The weather bureau. When the Commonwealth Bureau of Meteorology refused to provide weather information to MetService (the New Zealand Government's corporatised national weather forecasting service), the ACCC commenced proceedings under sec 46 alleging that the Bureau had taken advantage of its market power to prevent competition in the market for specialised services. A settlement designed to promote national competition policy was reached with the ACCC following court-sponsored mediation. Under the settlement, the Bureau agreed to provide MetService direct access to information, to publish an agreed access document, and to use a model licence agreement setting out conditions for access to weather information.

_____ *Commonwealth Bureau of Meteorology*⁴⁸ —

"Bus About Alice". P, the owner and operator of a passenger bus service in Alice Springs, unsuccessfully challenged under sec 46 the decision of the Federal Airports Commission (FAC) to deny P a licence to run a shuttle service from Alice Springs airport. There was no evidence that the FAC wished to deter or prevent P from entering the market, and it was prepared to grant a licence to P. The FAC's "purpose" was not to take advantage of its power to affect P, but was to ensure that the one licensed operator remained viable and able to meet all arriving flights including those at unpopular times. In any case, the conduct of the FAC was not the exercise of economic market power, but was the use of its regulatory power designed for the public benefit.

_____ *Plume v Federal Airports Corporation*⁴⁹ —

Street directories. The Melway street directory has about 80–90% of the retail market in Melbourne. When Melway refused to supply 30,000–50,000 directories to P and replaced P with P's former business associate as a wholesale distributor, P sued Melway under sec 46. The court held that in a competitive market Melway would not have refused to supply so many directories and that it had taken advantage of its market power in refusing

46. (1996) ATPR ¶41-510.

47. (1996) ATPR ¶41-466; (1996) ATPR ¶41-521 (Full Court); ¶8-040, ¶8-220.

48. Noted ACCC Journal, Issue 9, p 26 (June 1997).

49. (1997) ATPR ¶41-589.

to supply P. P was awarded damages for Melway's breach of sec 46 (under sec 82: ¶8-840) and an order to restrain Melway from refusing to supply if its purpose was to prevent P competing with other wholesalers or distributors (an injunction under sec 80: ¶8-810).

Melway Publishing Pty Ltd v Robert Hicks Pty Ltd
(t/a Auto Fashions Australia)⁵⁰ —

ACCC's power. The ACCC's regulatory and enforcement function is not "power in a market" for the purposes of sec 46. Hence the ACCC did not "take advantage" of any power in breach of sec 46 by publishing a media release critical of P.

*Giraffe World Australia Pty Ltd v ACCC*⁵¹ —

Alleged predatory pricing. The ACCC was unsuccessful in its sec 46 claim against Boral Better Masonry Ltd (Boral), the manufacturer of concrete masonry products:

- that it had taken advantage of its substantial degree of power in the market to eliminate or damage competitors (sec 46(1)(a)) and to deter or prevent competitors from competing (sec 46(1)(c)) by selling at less than the avoidable cost of production (not proved),⁵²
- that it had offered to buy the plant of a competitor (accepted), and
- that it did increase its capacity at its existing plant (accepted).

The court held that because of all the alternatives to concrete blocks for walls (such as tilt-up panels and clay bricks), the relevant product market was not concrete masonry products but was walling and paving products, and that Boral did not have a substantial degree of power in this wider market. There were many competitors in the market and low barriers to entry for new competitors and for this reason, and as an aside, the court noted that even if Boral did have market power, its conduct would not amount to predatory pricing as Boral would not have been able to recoup its losses by later charging supra-competitive prices.

*ACCC v Boral Ltd*⁵³ —

Remedies for breach of sec 46 include fines (¶8-770), injunction (¶8-810) or similar order. Unlike the equivalent law in the US, there is no divestiture remedy (¶8-850) for misuse of market power.

There is no authorisation for misuse of market power: ¶8-630.

50. (1999) ATPR ¶41-693.

51. (1999) ATPR ¶41-669; ¶7-250, ¶7-280.

52. For example, if the avoidable or variable cost of raw materials is \$6 and the fixed cost is \$4, a sale of over \$10 makes a profit. A sale at \$8 still covers the cost of raw materials but a loss is made by selling at \$6.

53. [1999] FCA 1318; (1999) ATPR ¶41-715, noted ACCC Journal, Issue 25, p 95 (February 2000); [1999] FCA 1641; (2000) ATPR ¶41-738, noted ACCC Journal, Issue 27, p 40 (June 2000); on appeal to the Full Federal Court. See generally Tse, V, *Predatory pricing — fact and fiction* (2000) 74(3) LJ 62.

EXCLUSIVE DEALING

Exclusive dealing: sec 47	¶8-360
Refusal to deal	¶8-390

¶8-360 Exclusive dealing: sec 47. Section 47 outlaws the practice of exclusive dealing, ie the practice whereby sellers or buyers deal subject to a condition which restricts the buying or selling decisions of their customers or suppliers. Essentially the section covers vertical restraints, which can arise in a number of ways involving positive or negative conditions such as:

- product exclusivity — A supplies B on condition⁵⁴ that B will not acquire goods or services from A's competitor C: sec 47(2)(d). This includes:
 - solus agreements (where A requires B to deal only with A);
 - minimum quantity contracts (where A will only supply B in quantities of say 100 units);
 - requirements contracts (where A requires B to buy a certain amount from A), and
 - tying, full line forcing or second line forcing (where A supplies B on condition that B acquires other goods or services from A). Examples of tying include brewery A requiring hotel B to buy only from A, or supplier A hiring a fridge to milkbar B on condition that B does not use it to store competitors' drinks.
- A supplies B on condition that B will not resupply goods or services acquired from A's competitor: sec 47(2)(e).
- customer exclusivity — A supplies B on condition that B will not re-supply C: sec 47(2)(f)(i).
- territorial exclusivity — A supplies B on condition that B will not re-supply in certain "places": sec 47(2)(f)(ii). Depending on how it is structured, a franchise agreement (¶9-985) where franchisor A restricts franchisee B may infringe this section.

Exclusive dealing is not an outright offence ("per se") and is only prohibited if it has the purpose or effect of substantially lessening competition in the market (sec 47(10)).

Parties may obtain protection until the Commission determines otherwise by notifying exclusive dealing conduct under sec 93 except in relation to third line forcing, where notification does not confer immediate immunity but only after the prescribed period (¶8-706).

In addition to or instead of using the notification procedure, parties engaging in exclusive dealing may also apply for authorisation (¶8-700).

54. "Condition" is defined widely in sec 47(13)(a).

— Example —

One contract/one product or one contract/two products: wedding receptions. Wedding reception centres which offer as part of their package of services a house photographer who works on behalf of the centre (whether a staff member or an outside photographer which whom the centre has a working relationship) are entitled to require the client to use that house photographer. But if photography is not truly part of the centre's "package", a client has a right to choose a photographer. A centre requiring a client to use an outside photographer nominated by the centre, thereby denying the client the freedom of choice, may constitute exclusive dealing as it potentially forces up the cost to clients and eliminates healthy competition among photographers for clients' custom.

Trade Practices Commission news-sheet on the wedding reception industry (1988) —

Exclusive dealing can be authorised on authorisation "test 1" — whether public benefit outweighs anti-competitive detriment (¶8-630, ¶8-700) — and it can be notified (¶8-706).

¶8-390 Refusal to deal. A supplier engages in exclusive dealing if it "refuses" to sell its products "for the reason that" the purchaser:

- has bought, or has not agreed not to buy, directly or indirectly, products from a competitor of the seller (sec 47(3)(d));
- has resupplied, or has not agreed not to resupply, goods or services which have been bought from such a competitor (sec 47(3)(e));
- has resupplied, or has not agreed not to resupply, goods or services bought from the seller to any or particular persons or in particular places (sec 47(3)(f)).

A refusal to deal for the purpose of achieving exclusive dealing is not prohibited unless it substantially lessens competition (sec 47(10)).

— Case example —

CSR's refusal to supply plasterboard to a supplier and installer of ceilings who dealt with CSR's competitor, equally contravened sec 47 and incurred the first pecuniary penalty for breach of sec 46 (¶8-300).

*TPC v CSR Ltd*⁵⁵ —

THIRD LINE FORCING

Third line forcing: sec 47(6) ¶8-410

Leases conditional upon exclusive dealing ¶8-420

¶8-410 Third line forcing: sec 47(6). Section 47(6) prohibits third line forcing outright ("per se") — regardless of its effect on competition. Third line forcing occurs where A supplies goods or services to B on condition that

55. (1991) ATPR ¶41-076.

B acquire other goods or services from C. This often happens under arrangements where A gets a commission or other benefit on sales by C to B.

For third line forcing, there must be an element of compulsion. If customer B is the passive recipient of goods or services from C (such as the "preferred carrier" QRX in the *Castlemaine Tooheys case*) and there is no contractual arrangement between B and C, there is no third line forcing.

— *Case examples* —

Legion Cabs. Legion Cabs provided a radio service for the members of its taxi fleet and operated a service station as a taxi base. Legion's rules required members to buy a quota of petrol from Shell, for which Legion received volume rebates. Penalties, including expulsion, were imposed on members who did not fulfil their petrol quota. This conduct clearly breached sec 47, and a pecuniary penalty was imposed.

— *TPC v Legion Cabs (Trading) Co-operative Society Ltd*¹ —

Castlemaine Tooheys Ltd (D) sold beer ex-Brisbane to north Queensland under a delivered price scheme via delivery by its "preferred carrier" QRX. The rival carrier (P), which had been effectively excluded by this arrangement, sued D under sec 47(6) alleging exclusive dealing in that (1) the services of QRX were forced on to retail beer outlets and (2) D supplied beer on condition that the retailers acquire the services of QRX. In allowing D's appeal against adverse findings in the Federal Court, the High Court analysed the arrangement as basically no more than sale by D and delivery to retailers. The High Court distinguished third line forcing cases including *In re Ku-ring-gai Co-operative Building Society (No 12) Ltd*.² The challenged contract was between D (not the retailers) and the preferred carrier QRX. There was no condition of supply that the retailers acquire their beer from QRX. They were free to take delivery from any of D's regional depots in north Queensland, as some did. Certainly D's arrangement presented a substantial barrier to entry for P and other carriers — perhaps sec 45 should have been used to challenge that arrangement which had secured to QRX a significant proportion of the particular market.

— *Castlemaine Tooheys Ltd v Williams and Hodgson Transport Pty Ltd*³ —

If a finance company says to a customer: "We will give you finance on condition that you acquire a car from an AGC-approved dealer", it breaches sec 47(6), even if the customer intends to buy the car anyway. (In contrast, the TPC authorises third line forcing of insurance on public benefit grounds provided consumers have a real choice about competitive alternatives: ¶8-705.)

— *KAM Nominees Pty Ltd v Australian Guarantee Corporation Ltd*⁴ —

1. (1978) 35 FLR 372; (1978) ATPR ¶40-092. Compare *The effects of regulation of the taxi industry*, TPC Bulletin, No 74, p 32 (February 1994).
2. (1978) 36 FLR 134; (1978) ATPR ¶40-094 (lending by building society on condition that borrower insure with nominated insurer, in breach of sec 47).
3. (1986) 162 CLR 395; (1986) ATPR ¶40-751; (1985) 64 ALR 536; noted (1987) 15 ABLR 179. See further Hurley, AC, *The Castlemaine Tooheys case and the interpretation of the "third line forcing" provisions* (1987) 61 ALJ 415; McEwin, RI, *Third-line forcing in Australia* (1994) 22 ABLR 114.
4. (1994) ATPR ¶41-325.

Chem Mart pharmacies. When a suburban pharmacy left the Chem Mart pharmacy chain to operate alone, D, a private health insurer, gave notice of its intention to terminate its health insurance agency or franchise and to transfer it to a competing local pharmacy which had joined the Chem Mart chain. D had no commercial relationship with Chem Mart, but most of its agents were Chem Mart pharmacies. D's conduct breached sec 47(7)(a) (refusal to supply services), but as D had not proceeded with the termination, no penalty was imposed on D.

*ACCC v Health Partners Incorporated*⁵ —

On the application of the ACCC, the court found that a solicitor had aided and abetted his client (sec 75B: ¶8-760) to engage in third line forcing in breach of sec 47(6). The client offered its "Sure Sale" auction program to real estate vendors based upon the solicitor's legal work including standard contracts and advice on promotional material — this included a condition that vendors acquire settlement services from the solicitor's firm. The ACCC settled the case, with the solicitor paying the ACCC's legal costs, agreeing to complete a trade practices course and agreeing to publish articles relating to the matter in industry publications.

*ACCC v Miller*⁶ —

Third line forcing can be authorised under authorisation "test 2" — does public benefit justify authorisation (¶8-630, ¶8-705) — and it can be notified (¶8-706).

¶8-420 Leases conditional upon exclusive dealing. Section 47(8) is directed at a corporation which grants, renews or continues a lease or licence subject to conditions of exclusive dealing/third line forcing. Exclusive dealing may include a condition that the lessee or licensee will not acquire (buy) goods or services from a competitor of the lessor or licensor corporation, or will not supply (or sell) goods or services to any particular persons or in particular places.

Refusal to lease: sec 47(9). A lessor or licensor also engages in exclusive dealing practice if it refuses to grant "or renew", or exercises a power or right to terminate, a lease or licence for the reason that the lessee or licensee has acquired or resupplied products of a competitor of the lessor or licensor, or supplied products to particular persons or in particular places. The refusal to lease may also be for the reason that the lessee has not acquired products from another person (not related to the lessor).

5. (1998) ATPR ¶41-604.

6. ACCC Media Release 54/99; noted ACCC Journal, Issue 21, p 28 (June 1999);

Brown, M, *ACCC chief clarifies stance on trade practices* (1999) 73(7) LIJ 26.

RESALE PRICE MAINTENANCE

Resale price maintenance: sec 48	¶8-440
The unlawful practices: sec 48 and 96	¶8-450
Refusal to supply for sale or resupply	
below specified price	¶8-460
Inducing not to sell or resupply	
below specified price	¶8-470
Agreement not to sell or resupply	
below specified price	¶8-480
Withholding supply for purpose of	
maintaining price	¶8-490
Using a statement likely to be understood	
as requiring a minimum resale price	¶8-500

¶8-440 Resale price maintenance: sec 48. Resale price maintenance is the practice of fixing the minimum price of a commodity at subsequent levels of distribution — where a supplier of goods or services for resale stipulates that the goods or services supplied must be resold at, or not below, a price which the supplier has fixed. It occurs, for example, when a manufacturer sets prices at which wholesalers must resell to retailers, or when a manufacturer or wholesaler sets the retail resale prices.

The practice is also referred to as vertical price fixing. It involves arrangement or acquiescence of persons who, because the fixing of prices takes place between persons engaged in business at different levels of the distribution system, are not considered to be in competition with each other. It is distinguished from horizontal price fixing which concerns agreement on prices by competitors, that is, persons who are engaged in business at the same level of the distribution system.

Resale price maintenance appeared to be common in the retail industry, and is still being flushed out by Commission action. Ignorance is often the cause, and staff training is therefore an important remedy.

Following upon recommendations of the Hilmer Report (¶8-020), sec 48 now applies equally to services, and authorisation is available for it on public benefit grounds (¶8-630).

¶8-450 The unlawful practices: sec 48 and 96. Section 48 provides in simple language that “[a] person shall not engage in the practice of resale price maintenance”. Effect on competition is not relevant (¶8-040), and the general prohibition is detailed in Part VIII of the *Trade Practices Act* (sec 96-100). Resale price maintenance can be authorised on public benefit grounds (sec 88(8A): ¶8-630).

The persons who can be guilty of resale price maintenance include a supplier (which can be a natural person: sec 96(1) and (2)), and a person acting on behalf of or by arrangement with a supplier (sec 96(6)). Where a

body corporate is involved, conduct of a director, servant or agent is deemed to be conduct of the body corporate: ¶8-760.

The acts set out in sec 96(3) as constituting resale price maintenance are (in summary) the following:

- (a) making it known that the supplier will not supply goods or services unless the reseller agrees not to sell or resupply below a specified price (¶8-460);
- (b) inducing or attempting to induce a reseller not to sell or resupply below a specified price (¶8-470);
- (c) entering or offering to enter into an agreement whereby the reseller agrees not to sell or resupply below a specified price (¶8-480);
- (d) withholding supply of goods or services because the reseller either has not agreed to sell or resupply below a price, or has sold or resupplied or is likely to sell or resupply below that price (¶8-490);
- (e) withholding supply of goods or services to a reseller because a third person who has obtained or wishes to obtain goods or services from the reseller either has not agreed not to sell or resupply below a specified price, or has sold or resupplied or is likely to sell or resupply below that price (¶8-490); or
- (f) using a statement likely to be understood as requiring a minimum resale price (¶8-500).

¶8-460 Refusal to supply for sale or resupply below specified price.

The first act of resale price maintenance is "making it known" that the supplier will supply goods or services only on condition that the seller agrees not to sell or resupply them below a specified price (sec 96(3)(a)). It is not necessary for the supplier to refuse supply, or for the other person to act on the representation for sec 96(3)(a) to operate:

— Case examples —

Hugo Boss. The Federal Court imposed a penalty of \$515,000 on Hugo Boss, a manufacturer, importer and wholesaler of prestige men's clothing, and \$75,000 on its managing director personally for resale price maintenance.

— *ACCC v Hugo Boss Australia Pty Ltd*⁷ —

Oakleys. The sole Australian importer of Oakley sunglasses, made in the US and making up 60% of sales in the premium sunglasses market for the 15 to 20-year-old age bracket, was found guilty of resale price maintenance for inducing or attempting to induce retailers to maintain its recommended retail prices: "Your account will be closed if there is any discounting." For 11 breaches of sec 48 (by virtue of sec 96(3)(a), 96(3)(b) and 96(3)(d)(ii)), the

7. (1996) ATPR ¶41-536, noted ACCC Journal, Issue 4, p 19 (August 1996).

court ordered the importer to pay penalties between \$35,000 and \$120,000 totalling \$500,000 and the ACCC's costs of \$120,000.

*ACCC v Sundaze Australia Pty Ltd*⁸ —

¶8-470 Inducing not to sell or resupply below specified price. Inducing or attempting to induce a retailer not to sell goods or services at a price less than a price specified by the supplier is unlawful under sec 96(3)(b). To induce is to strongly influence, for example by threat to tighten credit facilities or other disadvantages, or by promises of benefits.

Recommended resale prices: sec 97. Recommended retail prices such as the following do not infringe sec 96(3)(b) if they are only recommended and if there is no inducement or attempt to induce resale price maintenance: "The price set out or referred to herein is a recommended price only and there is no obligation to comply with the recommendation." (cf ¶8-120.)

Case examples

In the words of Sony's Queensland manager to a discounting wholesaler, "Now everyone we have been quoting under \$3,999 does not get supplied at this stage." Sony's attempts to enforce compliance by two Queensland wholesale distributors with its recommended retail prices led to three successful TPC actions under sec 48 for breaches under sec 96(3)(b), one under sec 96(3)(d)(ii) and two under sec 96(3)(e)(ii), and penalties were imposed against Sony under sec 76 (\$250,000), its Queensland State manager (\$25,000) and its national sales manager (\$12,000, for his part in the first offence only). Because of evidence of deliberate flouting of this law, the penalties were designed to outweigh the commercial advantage that resale price maintenance might have brought.

*Trade Practices Commission v Sony (Australia) Pty Ltd*⁹ —

Price Attack. Mayo International, a manufacturer and supplier of hair care products in Australia, would only sell its hair care products to Price Attack if Price Attack franchisees agreed to retail the products at Mayo's recommended retail price. Mayo promoted resale price maintenance through its sales representatives. For breaches of sec 96(3)(b), Mayo was fined \$46,000 (14 breaches) under sec 76 (¶8-770), its Managing Director fined \$20,000 (14 breaches) and a sales representative fined \$2,000 (2 breaches). In addition, Mayo and its Managing Director were ordered to pay the costs of the ACCC in the case.

*ACCC v Mayo International Pty Ltd*¹⁰ —

¶8-480 Agreement not to sell or resupply below specified price. Resale price maintenance includes entering into an agreement one

8. [1999] FCA 1642; (2000) ATPR ¶41-736, noted ACCC Journal, Issue 26, p 46 (April 2000). Oakley terminated the importer's exclusive distribution agreement shortly after the commencement of the ACCC case.

9. (1990) ATPR ¶41-031; (1990) ATPR ¶41-053.

10. (1998) ATPR ¶41-653, (1998) ATPR ¶41-654, (1998) ATPR ¶41-655, noted ACCC Journal, Issue 17, p 22 (October 1998).

of the terms of which is that the reseller will not sell or resupply or advertise goods or services for sale below a specified price; this practice is unlawful (sec 96(3)(c)). The actual entry or offer to enter into a resale price maintenance agreement may be made by the supplier or a person acting on behalf of or by arrangement with the supplier.

¶8-490 Withholding supply for purpose of maintaining price. Resale price maintenance includes (sec 96(3)(d)):

“... the supplier withholding the supply of goods [or services] to a second person for the reason that the second person—

- (i) has not agreed as mentioned in paragraph (a) [¶8-460]; or
- (ii) has sold, or is likely to sell, goods [or has resupplied, or is likely to resupply, services] supplied to him by the supplier, or goods [or services] supplied to him by a third person who, directly or indirectly, has obtained the goods [or services] from the supplier, at a price less than a price specified by the supplier as the price below which the goods [or services] are not to be sold”.

— *Case example* —

Action by the South Australian manager of a Japanese electrical products company to induce Whyalla Video not to advertise or to sell its goods at a price less than a specified price, enforced by refusal to supply, resulted in penalties on the electrical company of \$130,000 and on the manager personally of \$26,000 upon conviction. The initial denials by the company of the allegations were dropped upon disclosure of tape recordings of some of the offending phone conversations. An officer of the Trade Practices Commission had also overheard some of the phone conversations by loudspeaker.

— *TPC v General Corporation Japan (Aust) Pty Ltd*¹¹ —

Resale price maintenance also includes withholding supply for the purpose of maintaining price re a third party under sec 96(3)(e).

The action of the supplier is unlawful only if the supply of goods or services is withheld in order to enforce the specified resale price. Any other reason for withholding supply, eg the supplier's personal dislike of the retailer, will not be sufficient. Such other reasons may exist, however, but as long as resale price maintenance is the substantial operative reason for the withholding of supply, the supplier's action will be covered by the prohibition of the law.

Loss leadering: sec 98(2). A supplier may wish to withhold supplies from a seller who uses the goods or services as a “loss leader” to attract business (ie who sells or resupplies at below the cost to the trader), on the basis that the supplier's goods or services may gain a reputation as inferior. Section 98(2) allows a supplier to withhold supplies from a seller who has loss leadered in the previous year. However, genuine clearance sales of goods acquired for ordinary sale, and sales with the supplier's consent, do not fall within the loss leader exemption (sec 98(3)).

11. (1989) ATPR ¶40-922.

¶8-500 Using a statement likely to be understood as requiring a minimum resale price. Using price statements — printed, woven, etc as set out in sec 99 — likely to be understood by the reseller as a price below which goods or services are not to be sold is prohibited by sec 96(3)(f).

The prohibition of resale price maintenance extends to the practice of a supplier stipulating minimum prices at which a distributor may *advertise*, as distinct from sell or resupply, goods or services (sec 96(7)).

MERGERS AND OTHER ACQUISITIONS _____

Mergers and other acquisitions: sec 50 ¶8-570

The ACCC Merger Guidelines (1996 and 1999) ¶8-572

The TPC Merger Guidelines (1986) ¶8-573

The motives for and effects of mergers ¶8-580

¶8-570 Mergers and other acquisitions: sec 50. The *Trade Practices Act* aims to prohibit mergers which have the effect of substantially lessening competition in a market. Section 50 reads:

“50(1) A corporation must not directly or indirectly:

- (a) acquire shares in the capital of a body corporate; or
- (b) acquire any assets of a person;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

50(2) A person must not directly or indirectly:

- (a) acquire shares in the capital of a corporation; or
- (b) acquire any assets of a corporation;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.”

This “substantially lessening competition” test, in force from 21 January 1993, restored the merger test which was in force from 1974 to 1977. It now provides an anti-competitive conduct test which is in line with the other sections in Part IV. This test replaced the 1977-1992 prohibition only of mergers which led to dominance in the market.¹² Mergers which did not lead to dominance were outside the scope of former sec 50 even if they lessened

12. The 1992 amendments were supported by the Senate Standing Committee on Legal and Constitutional Affairs, *Mergers, Monopolies & Acquisitions — Adequacy of Existing Legislative Controls*, Canberra, AGPS, 1991 (the Cooney Report), noted (1992) 20 ABLR 270; the House of Representatives Standing Committee on Legal and

Constitutional Affairs (the Griffiths Committee), in their reports; see also *News & Fair Facts* (the Lee Report) and *A Pocket Full of Change* (the Martin Report: ¶16-020). See further Taperell, G, *Has the regime become tougher? Mergers and s 50 TPA*, LSJ, Vol 33, No 4, p 58 (May 1995).

competition and led to price rises, etc. Had the present anti-competitive test been the test in the 1980s, approval for mergers for example between News Corporation/Herald and Weekly Times and TNT-News/East-West Airlines (¶8-573) would probably not have been given.

— *Case example: sec 50(1)* —

Concrete blocks. In the first case brought by the ACCC seeking penalties for breach of sec 50(1), Pioneer was ordered to pay \$4.8m in pecuniary penalties. To increase profits, Pioneer acquired, without seeking ACCC authorisation, a competitor that made concrete blocks (the acquisition left Pioneer with 55% of the market, which would have triggered the concentration threshold of the ACCC's merger guidelines: ¶8-572, ¶8-710). As a result of the acquisition, Pioneer and one other competitor supplied almost all of the concrete blocks in the market. The court declared the acquisition to be in breach of sec 50(1), as it substantially lessened competition in the market: Pioneer had increased its market share, the third largest producer stopped competing in the market, Pioneer increased its prices and as a result the barriers to entry to the market were raised.

_____ *ACCC v Pioneer International Ltd and Pioneer Building Products (Qld) Pty Ltd*¹³ —

¶8-572 The ACCC Merger Guidelines (1996 and 1999). The ACCC has stated that it will use a five-stage process in evaluating mergers which incorporate the statutory factors set out in sec 50(3) (below) to be taken into account in assessing whether or not there is a substantial lessening of competition.

TPC five-stage merger evaluation process

- (1) *Market definition.* This refers to a threshold decision on whether a merger involving for example oil should be regarded as occurring in the oil market or in the energy market. Section 4E of the Act includes in the definition of “market” all goods or services that are substitutable for or competitive with the goods or services of the merging entities (¶8-040).
- (2) *Market shares/concentration levels.* Mergers which are not likely to result in a substantial lessening of competition are filtered out. The Commission will want to examine the potential competition effects of a merger if the merger results in:
 - the four largest firms having a market share of 75% or more and the merged firm having a market share of at least 15%; or
 - the four largest firms having a market share of less than 75% and the merged firm having a market share of 40% or more.

13. *Lockhart J*, Federal Court, 20 December 1996, unreported, noted in ACCC Journal, Issue 8, pp 1, 40 (April 1997). As the facts before the court and the

penalties were agreed between the parties, no written court decision was required or produced.

- (3) *Import competition.* If there is strong import competition, the merger is unlikely to be challenged.
- (4) *Barriers to entry.* The merger is unlikely to be challenged if there are low barriers to entry.
- (5) *Other structural and behavioural market features affecting competition,* such as the countervailing power of, for example, such powerful buyers that the seller is denied market power.

Section 50(3) statutory merger factors: competitive effects

In evaluating whether a merger is likely to have the effect of substantially lessening competition in a market, sec 50(3) requires regard to be had to the following non-exhaustive statutory merger factors:

- “the actual and potential level of import competition in the market” (sec 50(3)(a)). If competition from imports is an effective check on the exercise of domestic market power, it is unlikely that the Commission would intervene in a merger.
- “the height of barriers to entry to the market” (sec 50(3)(b)). Even if the merger breaches the concentration thresholds set out above, the threat of a new entrant can be a catalyst for competitive conduct by incumbent firms.
- “the level of concentration in the market” (sec 50(3)(c)). A merger which increases market concentration may enhance post-merger competition.
- “the degree of countervailing power in the market” (sec 50(3)(d)). A firm which depends on a small number of suppliers or buyers who are subject to competitive restraints of their own may be sufficient to prevent the merged firm from exercising an increased degree of market power.
- “the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins” (sec 50(3)(e)). There will have been a substantial lessening of competition if the merged firm can raise prices without competition from competitors, new entrants or imports.
- “the extent to which substitutes are available in the market or are likely to be available in the market” (sec 50(3)(f)). The Commission will go beyond the product market boundaries and examine substitute products in other markets.
- “the dynamic characteristics of the market, including growth, innovation and product differentiation” (sec 50(3)(g)). Factors include market share, brand loyalty to the firms’ products, technological developments and growth prospects of the market.
- “the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor” (sec 50(3)(h)). The Commission would be concerned if a “maverick” firm which undermined

attempts to co-ordinate the exercise of market power were the target of mergers, unless barriers to entry were low.

- “the nature and extent of vertical integration in the market” (sec 50(3)(i)). Vertical integration does not necessarily mean a substantial degree of power, and is governed by the same tests applicable to horizontal mergers. Potential anti-competitive effects include whether vertical integration is likely to facilitate price discrimination and price co-ordination.

This list of merger factors is not exclusive. Other factors may be relevant in assessing effect on competition, such as the extent of co-ordinated conduct by market participants.

— *Case example* —

Non-satellite Pay-TV. In a report prepared for the Australian Broadcasting Authority, the Commission advised that the allocation of non-satellite Pay-TV broadcasting licences to Star Vision (an affiliate of Australis Media) would not constitute a breach of sec 50. The allocation of licences would not enhance any market power of Australis Media, and would not be likely to substantially lessen competition in any market (such as the market for programming or the retail market). Supply side competition in the provision of transmission services is likely to increase and, on the demand side of the market, the alternative transmissions (TV and radio) are substitutes for non-satellite Pay-TV.

— *Star Vision Pty Ltd*¹⁴ —

The ACCC reported that in 1996-1997 it opposed only seven of the 147 mergers which it considered. Most merger reviews are instigated by external requests (from the parties, government agencies or private complainants) and only about 15% of merger reviews are conducted at the ACCC's initiative.¹⁵

¶8-573 The TPC Merger Guidelines (1986). The former Trade Practices Commission's 1986 Merger Guidelines (now withdrawn) encouraged “national champions” in the form of groups large enough to have international significance. Even if mergers resulted in high levels of industry concentration, they were seen to lead to industry rationalisation, increased productivity and international competitiveness. The Commission took the view that the then merger provisions did not usually operate:

- where (after a merger) there were two well-matched local competitors left in the market;
- where, despite the fact that there might be only one local major competitor left, there were a number of small independent competitors

14. (1994) ATPR (Com) ¶55-103, noted in TPC Bulletin, No 79, p 59 (December 1994).

15. ACCC, *The ACCC's approach to mergers: a statistical summary*, 1998,

noted CCH *Australian Trade Practices Reporter* ¶30-099; see further Robertson, D, *The regulatory assessment of mergers (and things like mergers)* (2000) 7 CCLJ 201.

who were viable and whose underlying economic circumstances were such that they had the opportunity to develop further; or

- where there was one local major producer left who faced effective competition from imports not heavily disadvantaged by tariff protection and representing a secure alternative source of supply in the longer term.

Several large mergers were finalised in 1987/1988 on this test such as the News takeover of Herald and Weekly Times, the TNT/News takeover of East-West Airlines and the Unilever takeover of Bushells under Commission surveillance with voluntary divestments so as not to affect the competitive balance.

— Example —

The takeover of the Herald and Weekly Times Ltd (HWT) by Rupert Murdoch's News Ltd (News) resulted in no one company achieving a dominant position by acquisition and no one company achieving power to behave to any appreciable extent independently of its competitors, advertising customers and the ultimate reading consumers. Announcing the practical completion of its involvement in the media acquisitions on 3 March 1987, the TPC accepted that News Ltd had become a prominent newspaper publisher as a result of the HWT takeover (a position previously held by HWT in any case). However, News had not been able to simply add HWT to its interests. It had divested and sold most of its major newspapers where overlap had occurred (except for the *Sunday Times* in Perth). As well as these sales leading to the emergence of three stronger newspaper groups (the Northern Star Group in Queensland and SA, the Bell Group in WA, and the United Media Group in WA), News still faced strong competition from John Fairfax Ltd in NSW and Victoria as well as the continuing presence of many suburban and country newspapers. The Commission was satisfied that the takeover had not increased concentration of ownership of the print media in Australia but had rather resulted in ownership becoming more widespread.

¶8-580 The motives for and effects of mergers. Merger provisions are appropriate in an Act relating to trade practices and competition because:

- (a) merger provisions are necessary to prevent the possibility of achieving, by merger, anti-competitive results prohibited elsewhere in the same law;
- (b) merger provisions ensure that the control of significant capital assets in the community does not change hands in circumstances that disregard any anti-competitive effects of the change.

A merger is not per se anti-competitive, and it may positively enhance the competitive process and give rise to a substantial benefit to the public with the entry of a strong and useful competitor from outside. A merger may lead to rationalisation in the industry, a containment of price increases, and the enhancement of industry stability in general.

In other words, the motives which lead a business to expand by taking over other going concerns are not always solely or wholly anti-competitive. (These, however, are not codified as a defence.) Economies of scale may result, industry rationalisation may occur, a failing company may be prevented from going to the wall, or the acquirer may just see a good opportunity for investment. It is sometimes suggested that caution should be applied to claims of expected benefits from proposed mergers as well as to estimates of potential costs to the economy arising from increased market power.

Ten points listing the different expected effects of mergers have been put together by American economist Professor Scherer. They are important in any discussion on mergers and competition law:¹⁶

- (1) to reduce competition and gain monopoly power;
- (2) to realise promotional profits;
- (3) to utilise complementary resources more effectively;
- (4) to secure promotional and physical distribution scale economies;
- (5) to secure promotional and pecuniary economies of scale;
- (6) to "rationalise" existing production operations;
- (7) to spread risks or move from declining to expanding fields;
- (8) to build an empire;
- (9) to pick up new capacity at bargain prices;
- (10) to expand production without depressing prices.

Costs of mergers can be considered under the following propositions:

- (1) mergers lead to lessening of competition, and this tendency to monopoly power may result in the raising of prices above marginal cost and reduction in output;
- (2) small businesses may be annihilated;
- (3) mergers "break up" companies with consequent detriment to employees and the community;
- (4) mergers allow companies to avoid other restrictive trade practices prohibitions;
- (5) mergers lead to absentee management, loss of local independence and undesirable concentration of wealth and power;
- (6) mergers generally involve political consequences;
- (7) resources are wasted in merger activity such as harmful defensive moves.

16. Scherer, FM and Ross, D, *Industrial Market Structure and Economic*

Performance, Boston, Houghton Mifflin, 3rd ed, 1990, Ch 4 and 5.

PART VII — RESTRICTIVE TRADE PRACTICES — AUTHORISATIONS AND NOTIFICATIONS

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¶8-620 Authorisation and notification: an overview. The *Trade Practices Act* provides that a party can apply for authorisation and notification for conduct in which it proposes to engage which might infringe the Act.

Authorisation. As outlined at ¶8-630—¶8-710, sec 88 of the Act empowers the Australian Competition and Consumer Commission (or, on appeal, the Australian Competition Tribunal: ¶8-730) to grant authorisation (dispensation) to agreements affecting competition which would otherwise be prohibited under the Act.

Notification. Notification provides interim protection to parties engaged in exclusive dealing and, as outlined at ¶8-706, the conduct in question is treated as not substantially anti-competitive until the notification is withdrawn or notice is given by the Commission, except in the case of third line forcing where a modified procedure applies.

¶8-630 What is authorisation: sec 88. An authorisation is a dispensation which the ACCC may grant for a restrictive trade practice which would otherwise breach the *Trade Practices Act*.

Authorisation is granted by the ACCC under one of two tests:

- (1) benefit outweighs anti-competitive detriment: sec 90(6),(7); or
- (2) the public benefit test: sec 90(8).

Authorisation test 1: Does public benefit outweigh anti-competitive detriment (sec 90(6),(7))? This test of authorisation, based on the effect on competition, applies to:

- contracts, arrangements or understandings which substantially lessen competition: sec 45(2)(a)(ii), 45(2)(b)(ii) (¶8-050); sec 88(1) (¶8-660);
- price fixing of goods and services: sec 45A (¶8-110); sec 88(1), 90(6);
- covenants running with land which have the purpose or effect of substantially lessening competition: sec 45B (¶8-180); sec 88(5);

¶8-630

- covenants in relation to prices: sec 45C (¶8-190); sec 88(5);
- exclusive dealing: sec 47(1) (¶8-360); sec 88(8), 90(6) (¶8-700).

Authorisation test 2: Does public benefit justify authorisation (sec 90(8))? Competitive evaluation is not part of this second test because anti-competitive considerations are not part of the offences in these areas:

- primary boycott/exclusionary provision: sec 45(2)(a)(i), 45(2)(b)(i) (¶8-220); sec 88(1);
- secondary boycotts: sec 45D (¶8-240); sec 88(7);
- third line forcing: sec 47(6), (7) (¶8-410); sec 88(8), 90(8)(a)(iii) (¶8-705);
- resale price maintenance: sec 48 (¶8-440); sec 88(8A) (¶8-707);
- mergers: sec 50 (¶8-570); sec 88(9), 90(9), (9A) (¶8-710).

Authorisation is not available for misuse of market power under sec 46 (¶8-300).

Meaning of public benefit. The expression “benefit to the public” relevant to both tests of authorisation has been interpreted as meaning:

“... anything of value to the community generally, any contribution to the aims pursued by the society including as one of its elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress.”¹⁷

Examples of public benefit given by the former TPC, now the ACCC, include:¹⁸

- (1) promotion of competition in an industry;
- (2) economic development such as the development of natural resources by encouraging exploration, research and capital investment;
- (3) fostering business efficiency, especially to allow business to compete more effectively with imports in the domestic market and exports on world markets;
- (4) industry rationalisation;
- (5) expansion of employment in efficient industries and in particular regions;
- (6) assistance to and promotion of efficient small business, for example by guidance on costing and pricing, and marketing initiatives such as buying groups;
- (7) enhancement of the quality and safety of goods and services and the expansion of consumer choice of the range of goods and services;

17. *QCMA/Defiance Holdings-Barnes Milling* merger authorisation review (1976) ATPR ¶40-012 at p 17,242; “market” and “competition” noted at ¶8-040.

18. TPC, *Objectives, priorities and work program for 1988-1989*.

- (8) provision of better information to consumers and business;
- (9) promotion of equitable dealings in the market;
- (10) promotion of cost savings in industry and the consequent containment or reduction of prices at all levels in the supply chain;
- (11) steps to protect the environment, such as industry arrangements to limit pollution.

Other examples of public benefit include:

- (12) the achievement of economies of scale or scope in production, distribution and/or marketing;
- (13) adjusting capacity to demand and/or reducing unit costs, and
- (14) investment in more efficient plant, equipment and distribution facilities.

— *Case example: public benefit* —

The benefits resulting from proposed conduct must be benefits to the public and not merely to the applicant or some other limited group. In response to the proposed removal of government protection of the Australian tobacco industry through the 1990s, the Australian Tobacco Leaf Corporation formulated voluntary marketing arrangements for setting prices, grades and quantities for the next crop which were almost identical to the government "stabilisation" scheme. Authorisation of the understandings under sec 88(1) was denied by the Commission on the basis that their anti-competitive effects would outweigh any public benefits: the understanding on prices could eliminate price competition between the three manufacturer buyers, and the proposed quota arrangements would provide continued protection to less efficient growers and therefore delay industry adjustment to a deregulated market.

— *Australian Tobacco Leaf Corporation Pty Ltd*¹⁹ —

Under the ACCC's rural marketing guidelines, there may be scope for authorisation of rural marketing arrangements because the increased market power available to buyers in the new environment of rural deregulation (from 1989) and concentrated industry may now not have an adverse effect on competition if balancing the market power of large buyers.²⁰

¶8-660 Authorisation of agreements substantially lessening competition (sec 45(2)(a)(ii), 45(2)(b)(ii)): sec 88(1). Contracts, arrangements or understandings which substantially lessen competition under sec 45 (¶8-050) may be authorised under sec 88(1) if they have a benefit to the public which outweighs anti-competitive detriment to the public (sec 90(6)).

19. (1992) ATPR (Com) ¶50-124.

20. ACCC, *Rural Guideline and the Trade Practices Act 1997*. The earlier 1989 edition was applied in, eg, *Winegrape Growers' Council of Australia*

Incorporated (1992) ATPR (Com) ¶50-114 (industry-indorsed indicative price scheme, as alternative to government regulation, to encourage flow of market information among growers and winemakers).

— *Case examples* —

Deregulation of real estate agents. During the early 1980s, the ACCC's predecessor (the TPC) denied authorisation to the then various real estate institutes — State, Territory and national — setting fixed fees and charges, standard terms for conjunction agency (where two agents agree to work together in selling or leasing) and sole or exclusive agency agreements, on the basis that they provided no public benefit. The following arguments in favour of public benefit were rejected:

- there is public benefit in the fixed scales of fees providing a common point of reference as to relative costs of services;
- reductions in services and service standards would follow on price rather than service competition;
- the scales have had wide acceptance over many decades with remarkably few complaints;
- without the scales there would be widespread dislocation and hence uncertainty amongst those using the services of real estate agents;
- complaints of overcharging (per scale) can currently be made to the Real Estate Institute of NSW;
- vendors know real estate fees in advance and have the benefit of that certainty;
- the scales have a restraining effect on the level of charges;
- difficulties in attempting to get the scales increased provide a stimulus to increase efficiency;
- without a common reference point, costs would be higher;
- individual agents might restructure charges for property sales on a fee for service basis regardless of result if no scale existed;
- development of cut-throat competition in the absence of scales will tend to result in dominance by a few relatively large firms;
- the scales ensure negotiating emphasis is on the ultimate price of a property;
- real estate agencies are generally small and lack in-house capability to devise their own scales to provide an economic return.

*Real Estate Institute of NSW Authorisation*²¹ —

The ACCC authorised a new Code of Conduct for real estate agents promoting ethical practice, and revoked the earlier code authorised in 1981 due to changed circumstances in the real estate industry brought about by deregulation from the 1980s. Public benefits include the promotion of higher standards of practice and increased consumer confidence in real estate transactions.

*Real Estate Institute of Australia Ltd*²² —

21. CCH *Australian Trade Practices Reporter* ¶4-218.35; 19 May 1980. Following action by the TPC in all jurisdictions, the Real Estate Institute of Australia and some governments, the real estate industry is now deregulated.

22. (2000) ATPR (Com) ¶50-279, noted ACCC Journal, No 25, p 83 (February 2000).

Authorised newsagents: deregulation. The Rules of the Newsagency Council and the Newsagency Agreement provided restrictive arrangements which covered the sale of publications by newsagents, reinforced by horizontal agreements between publishers regarding territories and the appointment of newsagents. For example, most outlets other than authorised newsagents were only able to obtain supplies via an authorised newsagent and they had to share the commission on a 50/50 basis with that newsagent regardless of their costs. The original rules were authorised in 1980/1982 and continued until 1999/2000.

Independent operators, seeking “equal opportunity” to distribute newspapers and magazines, were successful in the Australian Competition Tribunal (¶18-730) in having the authorisations revoked. (The ACCC authorisation in respect of home delivery of newspapers is to continue until 1 February 2001, to give the industry time to plan for deregulation.)²³

Under the new arrangements announced in 1999, publishers can negotiate directly with individual newsagents in the areas of retail sales, distribution to sub-agents and home delivery.

Sub-agents and convenience stores will be able to deal with publishers direct but will have to source supplies from the local newsagent unless they wish to negotiate with publishers to become newsagents in their own right.²⁴

Securities and futures markets. Since their establishment in Australia in the second half of the nineteenth century, the Australian stock exchanges, providing a market for the buying and selling of financial securities (¶13-400—¶13-420) have, apart from their accountability under legislation regulating such matters as taxation and companies, been largely self-regulating. In line with its objectives of ensuring industry efficiency, resulting community benefit and competition as a means to that end (¶8-010), the Trade Practices Commission in 1979 commenced its own stock exchange inquiry for the purposes of examination of the exchanges’ articles, business and listing rules as potentially in breach of sec 45 for the purposes of authorisation under sec 88. At the request of the Campbell Committee in 1979 (¶16-020), the Commission deferred its inquiry until 1980, but shortly after it was again deferred while a decision was made whether or not to transfer it to the then newly created NCSC (¶9-380). *Mandamus* (¶1-165) to compel the Commission to restart its inquiry was sought in the Federal Court by one of the protagonists, the then Australian Merchant Bankers Association, but the Commission did not defend the proceedings, giving the court an undertaking that its inquiry would proceed.

At issue were the following potentially anti-competitive factors:

(1) *Admission to entry and to partnership.* Before the involvement of the Commission, membership candidates could only be natural persons, and

23. *Re: 7-Eleven Stores Pty Ltd, Independent Newsagents Association, Australasian Association of Convenience Stores Inc* (1998) ATPR ¶41-666, noted ACCC Journal, Issue 20, p 11 (April 1999).

24. See further Minister for Financial Services and Regulation, Media Release 20/99 at www.minfsr.treasury.gov.au.

they had to meet criteria relating to experience, education, and personal and financial suitability, and had to secure the votes of at least three-quarters of the body with sole membership discretion — the exchange committee. These rules were seen to advance the interests of the exchange and its clients by ensuring unlimited personal liability, personal commitment to the exchanges' fiduciary arrangements and avoidance of potential conflicts of interest likely with corporate members.

In so far as these regulatory rules contributed to the more efficient operation of the stock market, the Commission accepted them on public benefit grounds, apart from the requirement to operate in partnership thereby excluding corporate membership. This rule effectively barred other financial intermediaries as competitors (banks, merchant banks and investment institutions) and was rejected by the Commission.

However, to give the exchanges time to reorganise, interim authorisation was granted to these admission rules until 1 April 1984. Following discussions by the Commission with key participants, and by the parties themselves to narrow the ground between them, agreement between the parties was reached in December 1983 and given interim authorisation, thereby marking the end of the old admission rules. From 2 July 1984, members could incorporate with 50% non-member shareholding of which 50% was to be held by "old brokers", viz those who were members at 31 March 1984. As from 1 April 1987, brokers can now incorporate with 100% membership by non-exchange members so long as a minimum of two or 25% of the company's board are exchange members.

(2) *Charges by brokers.* Before action by the Commission, exchange members were required to charge the prescribed brokerage, failure to do so constituting an offence subject to penalty. As price fixing (§18-110), fixed fees were unsupportable on efficiency and competitive grounds, and their failure to gain authorisation (interim authorisation to 1984) led to their removal. This change had not supported the proposition presented by the exchanges, namely, increased rates and diminished service for small investors and a move by brokers away from the smaller exchanges to centralise in Sydney and Melbourne for corporate and institutional clients.

(3) *Dealings on the exchanges.* Authorisation was granted to the rules dealing with such matters as trading on the floor of the exchanges, prohibiting dealing in new issues before they have been granted official quotation, prohibiting transacting business of securities of suspended companies. A further round of membership matters received authorisation in May 1987, covering such matters as qualifications for entry to exchange membership, membership fee, capital liquidity requirements, common ownership (precluding associated corporations trading with each other).

(4) *Other business activities of brokers.* Various ethical rules of the exchanges justified on consumer protection grounds of honesty and prohibition of false advertising (such as those restricting members' ability to engage in any activity beyond broking without exchange committee approval, and those preventing approaches to and unsolicited communications with non-clients — thereby protecting a client's existing broker with a "no poaching" effect) failed to gain authorisation on public benefit or any other grounds.

(5) *Listing on the exchanges* (listing rules). Authorisation on public benefit grounds was granted to the official list to the extent that it was found to contribute to the more efficient operation of the stock market (the list of all

securities which have been admitted to current quotation) and the power of the exchanges' committee to admit to or refuse listing, to suspend or withdraw listing and to require compliance with listing rules.

*Australian Associated Stock Exchanges/
Australian Stock Exchange Ltd²⁵* —

Many practices of the Australian Stock Exchange and the Sydney Futures Exchange have been authorised by the TPC/ACCC on the grounds that public benefit would outweigh anti-competitive detriment.

¶8-700 Authorisation of exclusive dealing (sec 47): sec 88(8). The ACCC may authorise exclusive dealing (sec 47(1): ¶8-360) under sec 88(8) on authorisation “test 1” (¶8-630) — does the public benefit outweigh the anti-competitive detriment? (sec 90(6)).

¶8-705 Authorisation of third line forcing (sec 47(6)): sec 88(8). The ACCC may give authorisation to third line forcing (¶8-410) if it is satisfied that in all the circumstances the conduct or practice would result in benefit to the public under authorisation “test 2” noted above at ¶8-630. In other words, public benefit does not have to be weighed against anti-competitive detriment (sec 90(8)(a)(iii)).

— Case example —

Authorisation under sec 88(8) was granted to the Adelaide Bank in respect of its insurance requirements for borrowers. These did restrict a borrower's choice of insurer to insurers which were prepared to enter into a concessions agreement with the bank, but concessions agreements were readily available, borrowers had a wide choice of insurers and this requirement was not seen as anti-competitive. The Commission confirmed that there was a substantial public benefit in the bank's insurance requirements because without them a bank might be reluctant to lend, or it might incur losses which would be passed on as higher interest rates and charges.

Adelaide Bank Limited²⁶ —

¶8-706 Notification of exclusive dealing (sec 47(1)) and third line forcing (sec 47(6)): sec 93. The *Trade Practices Act* gives immunity to corporations which engage in exclusive dealing or third line forcing which does not have anti-competitive effect. Under sec 93, the parties may give the ACCC notification setting out the particulars of the conduct or proposed conduct and receive interim protection from the ACCC for conduct that may otherwise breach the Act.

25. (1982) ATPR (Com) ¶50-049; (1984) ATPR (Com) ¶50-068, ¶50-075, ¶50-080; (1987) ATPR (Com) ¶50-053.

26. (1994) ATPR (Com) ¶50-163. A concessions agreement between lender

and insurer protects the lender if the borrower makes a material omission or misrepresentation in taking out the insurance, or fails to renew the insurance policy.

In the case of exclusive dealing, the ACCC may revoke protection from breach of sec 47(1) (¶8-360) if it finds that the conduct substantially lessens competition and there is sufficient public benefit flowing from the conduct to outweigh the lessening of competition (sec 93(3)).

In the case of third line forcing, the ACCC will revoke protection from breach of sec 47(6) (¶8-410) if the likely benefit to the public will not outweigh the likely detriment to the public (sec 93(3A)).

— *Case example* —

Shortly after BMW acquired Rover in 1994, BMW Australia required some BMW dealers in rural areas to acquire a Rover dealership as well. Notification of this third line forcing, lodged under sec 93(1), was revoked on the basis that the public benefit likely to result from the notified conduct (such as improving the economic viability due to synergies from a double dealership and increasing the competitive strategy of the BMW group) would not outweigh the likely detriment (reducing competition in the market for vehicle dealerships).

— *BMW Australia Ltd*²⁷ —

There is an appeal to the Australian Competition Tribunal (¶8-730) from a decision of the ACCC revoking the protection of a notification under sec 93.

¶8-707 Authorisation of resale price maintenance (sec 48, 96): sec 88(8A). Section 88(8A), added to the Act in 1995, permits authorisation of resale price maintenance on public benefit grounds such as those mentioned at ¶8-630: sec 90(8).

¶8-710 Authorisation of mergers (sec 50): sec 88(9). Mergers and other acquisitions which would result in a substantial lessening of competition are prohibited by sec 50 (¶8-570) unless an authorisation is granted by the Commission under sec 88(9) on public benefit grounds (sec 90(9)).

Public benefit, as noted above at ¶8-630, includes increased efficiency such as economies of scale, industry rationalisation and more efficient plant and equipment leading to lower unit costs and prices. Following the introduction of sec 90(9A) in 1992, public benefit includes the potential for increased exports, increased import substitution and increased international competitiveness.

Undertakings on mergers are legally enforceable under sec 87B, and sec 87C (added 1994): ¶8-866.

27. (1998) ATPR (Com) ¶55-001, noted ACCC Journal, Issue 14, p 45 (April 1998).

— Case example —

On its third application, TRWA, an Australian manufacturer of automotive steering gears (a wholly owned subsidiary of a US corporation (TRW)), was granted authorisation under sec 88(9) to acquire by merger its only rival, Kirby (holding a licence from a UK company, Bishop, to manufacture gears in Australia). Before the acquisition in 1991, the market share of Kirby was 43%, TRWA 22% and imports 35%. The Commission authorised the acquisition on the basis that a licence agreement with Bishop has been finalised, that TRWA would continue to supply TRW and Kirby parts after the merger, and that if TRWA attempted to raise prices or deny supplies, car manufacturers would be able to import gears directly using Bishop technology (and not return to TRWA).

_____ *TRW Australia Holdings Ltd*²⁸ _____

PART IX — REVIEW BY TRIBUNAL OF DETERMINATIONS OF COMMISSION _____

The Australian Competition and Consumer

Commission	¶8-725
The Australian Competition Tribunal	¶8-730

¶8-725 The Australian Competition and Consumer Commission. As the federal government body — spread across all capital cities — which administers the *Trade Practices Act 1974* (Cth), the Australian Competition and Consumer Commission, the ACCC (formerly the Trade Practices Commission, the TPC) is responsible for surveillance and enforcement of Commonwealth anti-competitive restrictive trade practices law and consumer law. The Commission has the power to prosecute breaches of the Act (¶8-770ff), and to authorise, on public benefit grounds, anti-competitive conduct which would otherwise be illegal (¶8-620ff). It plays an important role in structuring the business environment in the interests of economic efficiency and, as an important agent of government policy of micro-economic reform, the Commission is or has been involved in areas of competition policy such as the financial sector (¶8-660), the petroleum industry (¶8-470), media ownership (¶8-573) and the waterfront. To these ends, the Commission conducts research and seminars, and releases information circulars and its merger guidelines (¶8-572—¶8-573)).

The ACCC, which came into operation on 6 November 1995, resulted from the merger of the former TPC and the former Prices Surveillance Authority, as recommended by the Hilmer Report (¶8-020).

Also recommended by the Hilmer Report and commencing on the same day, the National Competition Council, a high level and independent analytical and statutory advisory body, was established by the Commonwealth, State

28. (1992) ATPR (Com) ¶50-127. See also, eg, *Re Queensland Independent Wholesalers Ltd* (1995) ATPR ¶41-438.

and Territory governments, to focus on specific referrals from government and on policy development in areas such as regulation review, access regimes, monopoly pricing and competitive neutrality.

¶8-730 The Australian Competition Tribunal. The Australian Competition Tribunal²⁹ is an appeal tribunal to test authorisation decisions of the ACCC (¶8-620—¶8-710).

Tribunal reviews are a rehearing, and the Tribunal undertakes its own consideration of the issues based on information presented during the hearing. Evidence is presented by parties who support the ACCC's decision as well as by those who do not. The role of the ACCC is to assist the Tribunal.

The jurisdiction of the Tribunal — at the instance of a person dissatisfied with an ACCC authorisation who has a “sufficient interest”³⁰ — is to review (¶1-160—¶1-165) by way of rehearing Commission decisions (¶8-725) to refuse, or to grant (unconditionally or subject to conditions), authorisation for agreements or practices that might otherwise breach:

- the anti-competitive conduct provisions of sec 45 (¶8-050), 45B (¶8-180), and 45D (¶8-240);
- exclusive dealing (sec 47: ¶8-360—¶8-390);
- mergers (sec 50: ¶8-570—¶8-580).

Review by the Tribunal involves a rehearing of the matter, and the Tribunal must decide for itself if the Commission's determination should be affirmed, varied or set aside (sec 101(2); 102(1)). As it is not bound by the technical rules of evidence, economic analysis and trading records can be admitted. Usually consisting of a bench of three — a Federal Court judge as President, an economist and an experienced business practitioner — the Tribunal's decisions reflect a blending of legal, economic and practical experience. As a valuable institutional resource, the Tribunal has had a decisive effect on the law affecting price agreements, resale price maintenance, exclusive dealing, self-regulation, and competition in a profession, and has detailed the basic concepts of “market”, “competition” and “benefit to the public” left unexplained by the legislation.

29. The forebear of the ACT, the Trade Practices Tribunal, was originally set up under the former *Trade Practices Act 1965* (Cth).

30. The applicant must have a “sufficient interest” in the authorisation procedures under sec 89 and 90A: *Re: Alliance Agreement — Application by PK Wakeman* (1999) ATPR ¶41-675.

PART VI — ENFORCEMENT AND REMEDIES UNDER THE TRADE PRACTICES ACT

Liability for contravention	¶8-750
Who is liable: sec 75B, 84	¶8-760
Rescission: sec 75A	¶8-765
Offences against Part IV and Part VB: sec 76-78	¶8-770
Enforcement of consumer protection provisions	¶8-780
Offences against Part V	¶8-790
Penalties: mitigating circumstances	¶8-800
Injunctions: sec 80	¶8-810
Interim injunction: sec 80(2)	¶8-820
Order to disclose information or publish advertisement:	
sec 80A	¶8-830
Actions for damages: sec 82	¶8-840
Divestiture — relief against unlawful mergers: sec 81	¶8-850
Other orders: sec 87	¶8-860
Power of court to prohibit payment or transfer of	
moneys or other property: sec 87A	¶8-865
Enforceable undertakings: sec 87B, 87C	¶8-866
Defences: sec 85	¶8-870
Mistake or negligence: sec 85(1)(a)	¶8-880
Reliance upon another person's information:	
sec 85(1)(b)	¶8-890
Another person's act or default, accident:	
sec 85(1)(c)	¶8-900
Publisher's defence: sec 85(3)	¶8-910
Failure to comply with product standards:	
sec 85(4) and 85(5)	¶8-920
Good faith defence: sec 85(6)	¶8-930

¶8-750 Liability for contravention. Enforcement action under the *Trade Practices Act* aims at compensation, preventing further contravention, undoing the effects of a contravention, and deterrence.³¹ Breach of Part IV (Restrictive Trade Practices), Part IVA (Unconscionable Conduct) and Part V (Consumer Protection) is by way of action under Part VI (Enforcement and Remedies).

Contravention of the *Trade Practices Act* exposes the parties to liability for:

(a) penalties—

(i) in restrictive trade practices cases, up to \$10m for corporations

31. The compliance issues are raised by the Australian Law Reform Commission in

its Discussion Paper *Compliance with the Trade Practices Act 1974*, December 1993.

- and \$500,000 for individuals (sec 76: ¶8-770). For breaches of sec 45D dealing with secondary boycotts, there are no penalties on individuals — the penalty for organisations is \$250,000;
- (ii) in consumer protection offences (except those in sec 51AA, 51AB: ¶5-755; sec 52, 65Q, 65R or 65F(9): ¶7-495) up to \$200,000 for companies and \$40,000 for individuals (sec 79: ¶8-780—¶8-790);³²
 - (b) injunction (sec 80: ¶8-810);
 - (c) in consumer protection offences, corrective advertising or disclosure of information to the public (sec 80A) (¶8-830);
 - (d) an order limiting prices or requiring a refund of money — for a breach of Part VB dealing with price exploitation under the GST (sec 80B: ¶7-505);
 - (e) damages (sec 82: ¶8-840);
 - (f) orders in respect of unconscionable conduct (sec 87(1C): ¶8-860);
 - (g) in case of mergers, divestiture of the corporate shares or assets illegally acquired (sec 81: ¶8-850);
 - (h) ancillary orders (including specific performance, rescission or variation of contracts, damages and the provision of repairs and spare parts) compensating persons who have suffered or will suffer loss or damage arising from contravention of Part V (sec 87: ¶8-860);
 - (i) in the event of proceedings under sec 79, 80, 82 and/or 87, an order to freeze assets (sec 87A: ¶8-865);
 - (j) in the event of breach of a written undertaking given to the Commission (sec 87B) or the Secretary to the Department (sec 87C: ¶8-866), an enforcement order.

Proposed amendments to TPA enforcement and remedies (2000). Proposed amendments to the *Trade Practices Act* are designed to ensure that the Act continues to provide protection to Australian business and consumers and continues to promote competition and fair trading.³³

The proposals include increasing the penalties in the consumer protection provisions to \$200,000 for individuals and \$1m for companies (¶8-780); enabling the making of a range of non-punitive and punitive orders such as community service orders, probation and adverse publicity orders (proposed sec 86C, 86D); providing for preference to be given to the payment of compensation to victims instead of the payment of penalties (proposed sec 79B); increasing the limitation period of sec 82(2) (¶8-840) and 87(1CA) (¶8-860) to six years; providing the ACCC with increased powers; providing for damages to be awarded under sec 82 for unconscionable conduct (¶5-755);

32. Penalties in most jurisdictions under the Fair Trading Acts are \$100,000 and \$20,000 respectively.

33. *Trade Practices Amendment Bill (No 1) 2000* (Cth), noted CCH *Australian Trade Practices Reporter* ¶30-210, ¶30-211.

amending the definition of “goods” for product recall purposes (¶7-495) and amending the merger provisions to recognise substantial markets within a “region of Australia” (¶8-570).

Private law rights. Consumer protection is further strengthened by provisions implying conditions and warranties into contracts between a consumer and the immediate supplier of goods or services (Div 2) (¶7-035); by the ability to rescind contracts or seek damages for breach of implied conditions (sec 75A: ¶8-765); and by the availability of actions against the manufacturer (or importer) of goods (Div 2A: ¶7-212). These provisions operate as a matter of private law between the parties to the transaction. They are not a matter of prohibition and hence are not subject to enforcement by the Commission.

¶8-760 Who is liable: sec 75B, 84. A person (including a company) who breaches the *Trade Practices Act 1974* (Cth) is liable for the penalties, damages, etc imposed by the Act. In addition, sec 75B,³⁴ derived from the criminal law concepts of aiding and abetting, places liability on a person such as a director or a marketing manager involved in an offence who:

- “(a) has aided, abetted, counselled or procured the contravention;
- (b) has induced, whether by threats or promises or otherwise, the contravention;
- (c) has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention; or
- (d) has conspired with others to effect the contravention.”

Section 75B is a procedural section which indicates how a person can be involved in a breach of the Act³⁵ by another person. Aiding or abetting specified conduct is established by proof of the knowledge of the essential elements of the conduct, and the aider or abetter must have had actual or constructive knowledge of the facts or elements necessary for the contravention.³⁶

A solicitor has been found guilty of aiding and abetting the breach by his client of the third line forcing provisions of sec 47(6): ¶8-410.

If the plaintiff cannot make out a case against the defendant for damages under sec 82 (¶8-840), “whatever operation sec 75B might otherwise have had, it has no legal consequences creating liability for damages”.³⁷

34. Also ASIC Act 1989 (Cth) sec 12GB(1); *Fair Trading Act 1987* (NSW) sec 61; 1987 (SA) sec 3(3); 1987 (WA) sec 68; 1989 (Qld) sec 5(9); 1990 (Tas) sec 29; 1992 (ACT) sec 40; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 87.

35. ie Part IV (¶8-030), Part IVA (¶5-755-¶5-756), Part IVB (¶7-500), Part V (¶7-230ff), sec 75AU (¶7-505).

36. *Yorke v Lucas* (1985) 158 CLR 661, (1985) ATPR ¶40-622; clarified by the

High Court in *Hamilton v Whitehead* (1988) 166 CLR 121; (1989) ATPR ¶40-923, noted (1989) 63 ALJ 569: a natural person (eg a managing director) can be an accessory to a corporate principal whose liability arises from the natural person's act.

37. *Hanave Pty Ltd v LFOT Pty Ltd* (1998) ATPR ¶41-658 at p 41,327.

For example, in the words of the court, "Clearly Mr [X], as the joint managing director of [X Pty Ltd] who made the representation on its behalf, was a person involved in [X Pty Ltd]'s contravention of sec 52. It follows that he, as well as [X Pty Ltd], is liable to pay the damages to which the applicants are entitled."³⁸

Conduct by directors, servants or agents: sec 84. Section 84³⁹ extends the common law of principal and agent by providing that where it is necessary to establish the state of mind of a body corporate in relation to conduct of the body corporate, the "state of mind" of a director, servant (in the legal sense, ie employee: ¶11-020) or agent acting within the scope of that person's actual or apparent authority is sufficient. Section 84(2) deems conduct engaged in on behalf of a body corporate by a director, servant or agent acting within the scope of actual or apparent authority, or by any other person at the direction of or with the consent of those persons, to be conduct engaged in by the body corporate. Section 84(2) extends the common law of principal and agent by attributing to a corporation the conduct of others for which the corporation would not necessarily be responsible at common law, and therefore a corporation may be liable for the acts of these representatives in the course of their employment even if not shown to have the actual authority of the corporation. Section 84 applies only to proceedings under sec 46 (¶18-300), Part IVA (¶15-755), Part V (¶7-230ff) and Part VB (¶7-505).

Section 84 ensures that knowledge of the corporation that is held only by its top management is the state of mind of the corporation, and hence large corporations with extensive management structures and smaller companies are treated equally under this section.

In addition to liability under sec 84, a corporation is liable for the conduct of an agent in accordance with normal agency principles set out at ¶11-260ff.

Apart from defences under specific sections, the defence of reasonable mistaken belief should be available where the defendant's state of mind is not an element of the offence.

¶18-765 Rescission: sec 75A.⁴⁰ Breach of a condition of a contract may entitle the innocent party to repudiate that contract and to recover any moneys paid under it (see ¶6-280; ¶6-320).

The *Trade Practices Act* preserves this right in sec 75A(4), and in addition provides a statutory right to rescind. This right arises where:

- there is a supply of goods to a consumer;

38. *Thompson v Ice Creameries of Australia Pty Ltd* (1998) ATPR ¶41-611 at p 40,709.

39. Also ASIC Act 1989 (Cth) sec 12GH; *Fair Trading Act 1999* (Vic) sec 145; 1987 (NSW) sec 70; 1987 (SA) cf sec 90; 1987 (WA) sec 82; 1989 (Qld) sec 95; 1990

(Tas) sec 39; 1992 (ACT) sec 48; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 93.

40. Also *Fair Trading Act 1987* (WA) sec 41; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 67.

- a breach of a Div 2 implied condition (on merchantability, etc: ¶7-035ff) has occurred (sec 75A does not give any remedy for breach of the warranties set out in sec 69(1)(b) and (c));
- the consumer has served notice on the corporation or has returned the goods to the corporation.

The consumer loses this right after a lapse of a reasonable time or if the goods are disposed of or damaged by the consumer. The right to rescind is not lost, however, even if ownership has passed to the consumer before the date of the notice of rescission. In this case ownership “revests” in the supplier, even if property has passed under the contract.

Rescission is not strictly speaking an action, prosecution or proceeding under Part VI of the Act; rather it is a statutory right deriving from Part V to provide a remedy for breach of the terms implied into consumer transactions by Part V, Div 2 of the *Trade Practices Act*. Section 68 (noted at ¶7-170) provides that a term of a contract purporting to exclude, restrict or modify the application of sec 75A is void.

¶8-770 Offences against Part IV and Part VB: sec 76-78. A person breaching Part IV (Restrictive Trade Practices) or Part VB (Price Exploitation in Relation to A New Tax System: ¶7-505) of the *Trade Practices Act 1974* (Cth) is liable to a “pecuniary penalty” under sec 76. Section 76 proceedings are brought by the ACCC (sec 77), and the pecuniary penalty is to be paid to the Commonwealth.

A pecuniary penalty under sec 76 is not a fine, and in contrast to proceedings for breach of Part V (“Consumer Protection”: ¶8-790), the proceedings are civil in nature and not criminal (sec 77). The proceedings are subject to the civil burden of proof (“on the balance of probabilities”), not the criminal burden of proof (“beyond reasonable doubt”) (¶2-140). Because of the “pecuniary penalty” which may be imposed, the courts accept that the words of Part IV and Part V should be interpreted in a similar manner to provisions imposing criminal liability.⁴¹

Section 78 confirms that criminal proceedings are not to be brought for breaches of Part IV or Part VB.

In contrast to Part IV offences, Part V offences usually cause direct loss to the consumer.

Amount of penalty for breach of Part IV and Part VB. If the court is satisfied that a person has contravened a Part IV or Part VB prohibition, it may order payment of a pecuniary penalty of up to \$10m for companies and \$500,000 for natural persons. Some big penalties have been imposed — the \$6m imposed on Mayne Nickless in 1994 in the *TNT/Ansett freight case* (¶8-110) is the biggest so far.

41. *Beckwith v The Queen* (1976) 135 CLR 569 at p 576.

Each penalty will be decided on the particular facts of the case, having regard to the following factors:⁴²

- “1. The nature and extent of the contravening conduct.
2. The amount of loss or damage caused.
3. The circumstances in which the conduct took place.
4. The size of the contravening company.
5. The degree of power it has, as evidenced by its market share and ease of entry into the market.
6. The deliberateness of the contravention and the period over which it extended.
7. Whether the contravention arose out of the conduct of senior management or at a lower level.
8. Whether the company has a corporate culture conducive to compliance with the Act, as evidenced by educational programs and disciplinary or other corrective measures in response to an acknowledged contravention.
9. Whether the company has shown a disposition to co-operate with the authorities responsible for the enforcement of the Act in relation to the contravention.”
10. Similar conduct in the past.
11. The financial position of the parties.
12. The deterrent effect of the penalties for breach of Part IV. On sentencing and penalties, compare ¶12-200.

The court may be guided by any agreement (sometimes referred to as a “plea bargain”) on the amount of penalty reached between the Commission and the defendant.⁴³ The court may make an allowance if the defendant withdraws its defence, admits liability and allows the Commission to save its costs of investigation and litigation.⁴⁴

42. *TPC v CSR Ltd* (1991) ATPR ¶41-076, per French J at pp 52,152-52,153. Numbers 10-12 were added in *ACCC v NW Frozen Foods Pty Ltd* (1996) ATPR ¶41-515; ¶8-110.

43. eg *ACCC v Pioneer Concrete (Qld) Ltd* (1996) ATPR ¶41-457 (penalties of \$6.6m imposed on each of three concrete companies: ¶8-050); proceedings

commenced by customers for compensation for losses suffered as a result of the offending conduct (ie the higher prices paid): *State of Queensland v Pioneer Concrete (Qld) Pty Ltd* (1999) ATPR ¶41-691.

44. As confirmed in the *TNT case* (¶8-110), where the parties negotiated the penalties: (1995) 69 ALJ 243; (1995) 69 ALJ 329.

¶8-780 Enforcement of consumer protection provisions.

Section 79⁴⁵ makes it clear that a person who contravenes a consumer protection provision (other than sec 52, 65Q, 65R and 65F(9): ¶7-495) is guilty of an offence. Of course, before a person can be convicted, all the elements of the offence must be proved beyond reasonable doubt. Intention will not generally be relevant to the proof of Part V offences.

Prosecutions for an offence may be instituted in court by summons upon information under the Rules of Court, and can be instituted by the Australian Competition and Consumer Commission (formerly the Trade Practices Commission) a person authorised in writing by the Commission, or a person authorised in writing by the Secretary of the Attorney-General's Department under sec 163(4) of the *Trade Practices Act*.

The penalties which can be imposed on conviction for the offence are, in the case of a company, a fine not exceeding \$200,000 and, in the case of an individual, a fine not exceeding \$40,000 (as from 1993). There is scope, as noted at ¶8-790, for the use of imprisonment in trade practices law.

Non-penal offences. Engaging in misleading or deceptive conduct, in breach of sec 52, is not an offence punishable by penalty but it does give rise to liability for injunction, damages, corrective advertising or disclosure of information and ancillary orders that the court may make. Unconscionable conduct in breach of sec 51AB (¶5-755; ¶7-285) leads to injunction and the remedies set out in sec 87 (¶7-850; ¶8-860).

¶8-790 Offences against Part V. Section 79 provides for fines of up to \$200,000 for companies and \$40,000 for individuals for breaches of Part V (Consumer Protection).⁴⁶ It also catches attempts and conspiracy to break this law (sec 79(1)).⁴⁷ The Act also authorises the Court to grant an injunction (sec 80: ¶8-810—¶8-820), make an order for corrective advertising (sec 80A: ¶8-830), make ancillary orders under sec 87 (¶7-850; ¶8-860) and freeze assets (sec 87A: ¶8-865).

The discretion of the court to determine the amount of fine to be imposed was confirmed in the foundation *Sharp Corporation case* in 1975⁴⁸ where, for example, *Smithers J* stated that to fix a penalty a number of matters have to be considered:

45. Also ASIC Act 1989 (Cth) sec 12GB; *Fair Trading Act 1999* (Vic) sec 142; 1987 (NSW) sec 62; 1987 (SA) sec 75; 1987 (WA) sec 69; 1989 (Qld) sec 92; 1990 (Tas) (each penal section contains its own penalty); 1992 (ACT) sec 41; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 88.

46. There are no fines for breaches of sec 52: ¶7-250ff. Penalties for breach of sec 65F, 65Q and 65R are set out in the section

itself: ¶7-495. There are also no fines for breach of the unconscionability provisions of Pt IVA: ¶5-755.

47. Many claims under the Act also include the claim of aiding and abetting or otherwise participating in a contravention of the Act.

48. *Hartnell v Sharp Corporation of Australia Pty Ltd* (1975) ATPR ¶40-003; see ¶7-300.

"... First, the importance of untrue statements and the departure from standards; secondly, the degree of wilfulness or carelessness in the making of these statements; thirdly, the degree that the statement departs from the truth; fourthly, the degree that the statement has been disseminated. Next, what efforts have been made to correct the situation; finally we have to look at it in the context of the Act and to consider the deterrent effect of any penalty that we must impose. ... there can be no doubt that Parliament intended the penalty of \$50,000 [now \$200,000 for corporations, \$40,000 for individuals, as from 1993] to be used by the courts where there were serious breaches. It is hard to know what exactly would be the top breach involved."

Imprisonment. Case law recognised that the courts have the power to imprison for non-compliance with penalties imposed under either State legislation or the *Crimes Act 1914* (Cth): otherwise the impecunious would infringe the Act with impunity and cause great loss and damage to people by virtue of their conduct. Section 79A, added in 1986, confirms the power to imprison, at the rate of one day per \$25 of unpaid fine up to a maximum of three years.⁴⁹

¶8-800 Penalties: mitigating circumstances. In some of the court rulings above it is noted that certain mitigating circumstances were taken into account in fixing the appropriate penalty, including the following:

- that nobody was deceived by the defendant's conduct;
- that the defendant did not act dishonestly, or that the directors of the defendant company did not deliberately plan to mislead or that the company directors were perfectly frank with the officers of the Commission and equally frank with the court;
- that the defendant was not a large organisation, or that the defendant company was a family corporation whose corporate net profits over the last three years had been of a modest nature, or that the defendant company had very limited assets;
- that the defendant had taken steps to ensure that no further offence would be committed;
- that the defendant company did not engage in any form of advertising through media channels or by direct distribution of its offending material;
- that there were very few sales of the goods, or that the use of the defendant's goods did not constitute a safety hazard;
- that the defendant has undertaken to implement an effective trade practices compliance program.

49. Also ASIC Act 1989 (Cth) sec 12GC. Imprisonment is not an option under the *Trade Practices Act* to enforce payment

of moneys such as costs, damages or compensation under sec 87(1A) (¶8-860) other than fines: *TPC v Farrow* (1990) ATPR ¶41-018.

Losses due to publicity. Publicity and other persuasive measures may have a role to play in the enforcement of consumer law (¶7-940), but the careless use of such measures may contravene the basic legal proposition that a person is regarded as innocent until proved guilty.¹

¶8-810 Injunctions: sec 80.² Section 80 is essentially a public interest section giving the court power to grant an injunction where it is satisfied that “a person has engaged, or is proposing to engage” in conduct which breaches or threatens to breach the Act (sec 80(1)).³ There must be a sufficient “nexus” between the breach and the injunction granted, and the injunction must be related to the subject of the court proceedings.

The applicant for an injunction need not show that a proprietary interest is affected or that any damage has been suffered. Section 80 is a public interest section because:

- many people may incur considerable loss or damage as a result of conduct in breach of the Act, and
- proceedings may be commenced by the Commission or (except for merger and GST (Part VB) cases: sec 80(1A)) “any other person”.

The injunctions available under sec 80 include an interim injunction (sec 80(2): ¶8-820). The injunction may be a mandatory (compulsive) injunction, such as an injunction requiring the publication of corrective advertisements. Section 80 is the source of the injunctive power, and it is not confined to injunctive principles observed in the courts of equity (¶6-410).

— Case examples —

Advertisements in newspapers headed “A message from those Who Do ... to those Who Don’t” were published by the Tobacco Institute disparaging the notion that passive smoking involves health risks. In particular, two of the paragraphs read “... there is little evidence and nothing which proves scientifically that cigarette smoking causes disease in non-smokers”, and “[t]he Institute’s conclusions are based on a wealth of statistical detail from a study involving 12,000 people.” Many complaints were received by the Trade Practices Commission, and the TPC negotiated a form of corrective advertising (¶8-830) which was later published. AFCA (the Australian Federation of Consumer Organisations Inc) was dissatisfied with the form of the corrective advertisement, and commenced proceedings as “any other person” for an injunction under sec 80 based on alleged contraventions of sec 52.

1. *Eva v Southern Motors Box Hill Pty Ltd* (1977) 30 FLR 213 at p 222; (1977) ATPR ¶40-026 at pp 17,359-17,360.

2. Also ASIC Act 1989 (Cth) sec 12GD; *Fair Trading Act 1999* (Vic) sec 149; 1987 (NSW) sec 65; 1987 (SA) sec 83; 1987 (WA) sec 74; 1989 (Qld) sec 98; 1990

(Tas) sec 34; 1992 (ACT) sec 44; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 89.

3. ie Pt IV (¶8-030), Pt IVA (¶5-755-¶5-756), Pt IVB (¶7-500), Pt V (¶7-230), sec 75AU (¶7-505).

The advertisements were found to breach sec 52, as they were demonstrably false. There was much epidemiological evidence supported by strong biological plausibility to refute especially the first quotation. The advertisements gave the impression that those prone to asthma attacks were not at risk by being exposed to cigarette smoke, but this was contradicted by overwhelming evidence which was not really disputed by the Tobacco Institute. AFCCO was successful in gaining orders restraining the Tobacco Institute's advertising, but no order was made for corrective advertising. Three-quarters of its costs were awarded to AFCCO.

*Australian Federation of Consumer Organisations Inc
v Tobacco Institute of Australia Ltd*⁴ —

Section 80 was invoked by a member of the anti-uranium lobby, in an application for an injunction to restrain television advertising of the Australian Uranium Producers Forum. His contention was that the advertisements contravened sec 52 and 55 of the Act because they gave misleading or deceptive information on the subjects of uranium mining, nuclear power, energy needs and related subjects. The injunction application was successful.

*Phelps v Western Mining Corporation Ltd*⁵ —

Section 80 which allows "any other person" to sue is not to be read down to apply only to persons affected by a breach of Part V — it "means what it says ... [t]he word 'any' does not lend itself to a restrictive interpretation."⁶

Section 170 and legal aid. This section allows any person involved in proceedings under various sections of the Act⁷ to apply to the Attorney-General for legal aid (cf ¶7-760).

*Injunction granted by consent: sec 80(1AA).*⁸ The court may grant an injunction by consent of all the parties, such as an order at the request of the ACCC that an offender implement a trade practices compliance program. Such a program must specifically relate to the offending conduct rather than to the Act in general and it must be no wider than one designed to prevent repetition of the offending conduct.⁹ If a court made an order in general, the order might be unconstitutional in not being the result of the court's exercise of judicial power as defined in sec 71 of the Constitution (¶1-475).

4. (1991) ATPR ¶41-079; (1991) ¶41-138, (1991) 30 FCR 548; also (1993) ATPR ¶41-199; (1993) 41 FCR 89; (1993) ATPR ¶41-222, noted (1993) 67 ALJ 487. The Tobacco Institute failed in later proceedings under the *Fair Trading Act 1987* (NSW) sec 42 to restrain allegedly misleading or deceptive publicity about the case brought by anti-cancer interests: *Tobacco Institute of Australia v Woodward* (1994) ATPR ¶41-285. Also *United States Tobacco Co v Minister for Consumer Affairs* (1988) 20 FCR 520; (1988) ATPR ¶40-909, noted (1989) 17 ABLR 87.

5. (1978) 33 FLR 327; (1978) ATPR ¶40-077 as discussed in Mobbs, MM, *Legal aid in the public interest* (1978) 3 Legal SB 231.

6. *Truth About Motorways Pty Ltd v Macquarie Infrastructure Investment Management Ltd* [2000] HCA 11; (2000) ATPR ¶41-757 at para [13] and [15].

7. Pt IVB, Pt VA, Pt VI or sec 163A.

8. Similarly ASIC Act 1989 (Cth) sec 12GD(2).

9. eg *ACCC v Office Link (Aust) Pty Ltd* (1997) ATPR ¶41-598.

¶8-820 Interim injunction: sec 80(2). The court has the discretion under sec 80(2), in the interests of consumers as well as in the interests of trade competitors, to grant interim injunctions.

The test of granting an interim injunction is to inquire (1) whether there is a serious question to be tried, and then (2) to determine the matter on the balance of convenience.¹⁰ An applicant for an interim injunction does need to have a proprietary interest which may be affected or exposure to damage.

This test for an interim injunction is the same whether it is a prohibitory injunction or a mandatory injunction.

The court may accept undertakings from the parties instead of issuing an interim injunction.

¶8-830 Order to disclose information or publish advertisement: sec 80A. Section 80A¹¹ empowers the court on the application of the Minister or the Australian Competition and Consumer Commission (formerly the Trade Practices Commission) to order advertisers found to have contravened a provision of Part V (Consumer Protection) to disclose information or to publish a corrective advertisement. An order under sec 80A must be used protectively and not as a punishment.¹² In addition, a mandatory injunction to require publication of corrective advertisements can be awarded under sec 80 to "any other person" (¶8-810), for example on the grounds of misleading and deceptive conduct (sec 52: ¶7-250ff), thereby opening the scope of this remedy to other persons such as competitors¹³ and consumers.

Corrective advertising has existed in the United States for a number of years, and has been used in four areas of advertising: product composition, product origin, product benefits, and product safety.

— Case examples —

Listerine case. The manufacturer was ordered to stop advertising that Listerine mouthwash prevented or assisted in the cure of the common cold. A corrective advertising order was made requiring the company to disclose in future advertisements that: "Contrary to prior advertising, Listerine will not help prevent colds or sore throats or lessen their severity". Moreover, the

10. *American Cyanamid v Ethicon Ltd* [1975] AC 396; adopted in eg *Australian Coarse Grain Pool Pty Ltd v The Barley Marketing Board of Queensland* (1983) 57 ALJR 425 at p 425; *Sony Music Australia Ltd v Tansing (t/a Apple House Music)* (1993) ATPR ¶41-279. See further Sofronoff, W, *Interlocutory injunctions having final effect* (1987) 61 ALJ 341; Malcolm, DK, *The penetration of equitable principles into modern commercial law — Part 1* (1987) 3 Aust Bar Rev 185 at p 188.

11. Also ASIC Act 1989 (Cth) sec 12GE; *Fair Trading Act 1999* (Vic) sec 153; 1987 (NSW) sec 67; 1987 (SA) sec 83; 1987 (WA) sec 75; 1989 (Qld) sec 98; 1990 (Tas) sec 36; 1992 (ACT) sec 45; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 90.

12. *TPC v Telstra Corporation Ltd* (1993) ATPR ¶41-256.

13. As in *David Golf & Engineering Pty Ltd v Austgolf Corporation Pty Ltd* (1993) ATPR ¶41-207.

company was ordered to carry this corrective advertisement until it had spent an amount equal to its annual advertising budget over the preceding ten years, viz \$10m.

*Warner-Lambert Co v FTC*¹⁴ —

“[I]mprove your SEX LIFE”. Following complaints from a competitor and from a medical group, corrective advertising under sec 80A was ordered to counter assertions that D’s impotency treatment was the “only proven treatment”.

*ACCC v On Clinic Australia Pty Ltd*¹⁵ —

Hungry Jack’s was ordered to publish corrective advertising to warn that promotional sunglasses — which did not comply with the relevant safety standard (under sec 65C: ¶7-495) — were “NOT SUITABLE FOR DRIVING”.

*ACCC v Hungry Jack’s Pty Ltd*¹⁶ —

The corrective notice published by the REIWA as part of its settlement with the ACCC for breaches of sec 45(2) and 45A did more than announce the ACCC’s “win”: it was designed to have a deterrent effect by showing others in the market how the contravener will have to change its conduct.

*ACCC v Real Estate Institute of Western Australia Ltd*¹⁷ —

¶8-840 Actions for damages: sec 82.¹⁸ A person who suffers loss or damage by the conduct of another person that was done in contravention of a restrictive trade practices provision (Part IV), an industry code (Part IVB: ¶7-500), a consumer protection provision (Part V Div 1, 1A; not Div 2 or Div 2A) or sec 51AC dealing with unconscionable conduct in business (¶5-756) may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention (¶8-760), so long as the plaintiff’s loss or damage is *caused by* the offending conduct of the defendant. The word “by” expresses the notion of causation.¹⁹ Entitlement to recover loss or damage under sec 82 is not therefore confined to persons who rely upon the contravening conduct.²⁰

Breach of an implied term in Part V Div 2 (¶7-035—¶7-110) is actionable as breach of contract, not under sec 82.

Action must be commenced within three years after the date on which the cause of action accrued, which has been held to be when the loss or

14. *Warner-Lambert Co v FTC* Trade Reg Rep §20,926 (1975).

15. (1996) ATPR ¶41-517.

16. (1996) ATPR ¶41-538, noted in ACCC Journal, Issue 8, p 4 (April 1997).

17. (1999) ATPR ¶41-719; ¶8-110

18. Also ASIC Act 1989 (Cth) sec 12GF; *Fair Trading Act* 1999 (Vic) sec 159; 1987 (NSW) sec 68; 1987 (SA) sec 84; 1987

(WA) sec 79; 1989 (Qld) sec 99; 1990 (Tas) sec 37; 1992 (ACT) sec 46; *Consumer Affairs and Fair Trading Act* 1990 (NT) sec 91.

19. eg *Hanave Pty Ltd v LFOT Pty Ltd* (1998) ATPR ¶41-658 at p 41,328.

20. eg *Gaffikin Marine Pty Ltd v Princes Street Marina Pty Ltd* (1995) ATPR (Digest) ¶46-149.

damage is actually suffered, rather than the date of entry into an agreement alleged to breach the Act.²¹ In contrast, sec 52 is not time barred when it is raised as a defence, because sec 82(2) only imposes a time limit on an "action".²²

The Act does not prescribe the measure of damages under sec 82. Many claims for damages for breach of Part IV or Part V (especially for breach of sec 52) will be the measure of damages in tort (¶4-180), but the Act has a wide application and the measure of damages in contract may sometimes be appropriate, for example for breach of an implied condition (¶7-035).

The test is not "compensation on the basis of lost expectations", but is instead "how much worse off the plaintiff is as a result of entering into the transaction which the representation induced him to enter than he would have been had the transaction not taken place".²³

In the words of the High Court: "It follows, then, that a comparison must be made between the position in which the party that allegedly has suffered loss or damage is and the position in which that party would have been but for the contravening conduct ... sec 82 requires identification of a causal link between loss or damage and conduct done in contravention of the Act."²⁴

— Examples of sec 82 —

- an insured person cannot recover compensation for the inadequacy of the policy issued (beyond perhaps a small amount for distress). There would be the foundation for a damages award if the evidence showed that the insurer's conduct deprived the insured of the opportunity of entering into a different insurance contract.²⁵
- If there was misrepresentation, damages may be awarded on the difference between the position the plaintiff was in and the position the plaintiff might have been in had the misrepresentation not occurred (analogous to the measure of damages for the tort of deceit: ¶4-180).²⁶
- A third party payment (such as a statutory payment by the government to a dairy farmer to leave the industry) should not be deducted from a damages payment under sec 82 for breach of sec 52 (misleading or deceptive conduct) if the third party payment arises independently of and in addition to any compensation under sec 82.²⁷

21. *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514; (1992) ATPR ¶41-189 (High Court).

22. *Australian Mutual Provident Society v Specialist Funding Consultants Pty Ltd* (1991) 24 NSWLR 326; (1991) ATPR ¶41-137, noted (1992) 66 ALJ 541.

23. *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1 at p 14.

24. *Marks v GIO Australia Holdings Ltd* (1998) 73 ALJR 12 at para [42].

25. *Zoneff v Elcom Credit Union Ltd* (1990) ATPR ¶41-058.

26. *Munchies Management Pty Ltd v Belperio* (1989) ATPR ¶40-926.

27. *Masters Dairy Ltd v Nagy* (1998) ATPR ¶41-651.

- Damages may be awarded for the loss of a marriage relationship following the stress of conduct infringing the Act.²⁸

Consider the following case example:

— *Case example* —

Damages against the vendor for misleading or deceptive conduct under sec 52 (¶7-250) in its “Summary Report” for the failure of a purchased coffee shop business were awarded to the purchaser based on the extent to which the actual profitability of the business fell short of the notional profitability represented by the purchase price.

— *Radferry Pty Ltd v Starborne Holdings Pty Ltd*²⁹ —

Exemplary damages (providing punishment for the offending conduct: ¶4-200) are not available for breach of Part V. In contrast, aggravated damages (providing compensation for injury to the plaintiff’s feelings: ¶4-200) are available for breach of Part V.³⁰

Liability under sec 52³¹ is apparently joint and several, which means that if several people have caused the plaintiff’s loss (joint liability), the plaintiff may choose to hold any one defendant fully liable (several or separate liability).³²

The *Trade Practices Act* does not provide for a right of contribution or indemnity between the defendants in an action for damages.³³ This means that all the claims arising out of a single breach cannot be resolved in the one case, and separate cases may result in inconsistent findings of fact on the same subject by different courts.

¶8-850 Divestiture — relief against unlawful mergers:

sec 81. If a merger proceeds in contravention of sec 50, the court, on the application of the Australian Competition and Consumer Commission (formerly the Trade Practices Commission) or any other person having an interest, can order the disposal of shares or assets acquired in contravention. For example, the court can order a sale of shares.³⁴

Section 81 does not provide for a penalty or forfeiture, and it is like a mandatory injunction aimed at undoing the effects of breach of sec 50. Even though sec 50 provides for “acquisition of property” on other than “just terms”, it is not unconstitutional for breach of sec 51(xxxi) of the Constitution (¶1-475) because it is the consequence of a breach of sec 50.³⁵ Divestiture is

28. *Crago v Multiquip Pty Ltd* (1998) ATPR ¶41-620; ¶7-212.

29. (1999) ATPR (Digest) ¶46-189; ¶8-860.

30. *Nixon v Philip Morris (Australia) Ltd and Philip Morris Ltd* (1999) ATPR ¶41-707.

31. And under *Fair Trading Act* equivalents and *Corporations Law* sec 995.

32. Joint Commonwealth and NSW draft legislation in 1996 proposes proportionate several liability (ie liability proportionate

to each defendant’s degree of responsibility) in some situations: ¶4-290.

33. eg Seddon, N, *Misleading conduct: the case for proportionality* (1997) 71 ALJ 146.

34. See *Australia Meat Holdings Pty Ltd v TPC* (1989) ATPR ¶40-932; later developments noted (1994) 68 ALJ 759.

35. *TPC v The Gillette Company (No 2)* (1993) ATPR ¶41-268.

not available for misuse of market power under sec 46 (¶8-300) as it is under the equivalent law in the US.

¶8-860 Other orders: sec 87.³⁶ Section 87 (introduced at ¶7-850 in the context of increasing access to the courts) gives the court the power to make orders to compensate, prevent or reduce the loss or damage suffered or likely to be suffered by a person as a result of breach of the Act. As with a damages award under sec 82 (¶8-840), the applicant must establish that the loss or conduct was caused *by* the defendant.

The court has wide powers under sec 87(2) to “rewrite” contracts that are in breach of the Act or to readjust the position between parties, such as the power to declare a contract void or to order a refund of the purchase price.³⁷ Orders have been made under sec 87 varying the terms of a lease³⁸ and mortgage,³⁹ authorising an arbitrator to order the return of computer hardware,⁴⁰ declaring void a contract which was entered into in reliance on misleading or deceptive conduct and directing a refund of the deposit and accruals to the purchasers with costs⁴¹ and rescinding a contract (if the parties can be restored to their pre-contract position).⁴² An applicant under sec 87 must demonstrate a likely future loss so as to qualify for an award of damages. The award of damages under sec 87 is an amount to compensate for the loss or an amount to prevent loss or to reduce it. As with sec 82, sec 87 does not attract damages equivalent to those for loss of bargain in contract.⁴³

Section 87 also empowers the court to grant an injunction restraining a person from removing or dissipating assets which are within the jurisdiction (a Mareva order: ¶6-415), and to make an Anton Piller order (inspection/seizure of documents, etc to prevent their destruction or concealment: ¶6-416).

It is arguable that a right of contribution can be made out under sec 87⁴⁴ or under the general law or in equity.⁴⁵

36. Also ASIC Act 1989 (Cth) sec 12GM; *Fair Trading Act 1999* (Vic) sec 158; 1987 (NSW) sec 72; 1987 (SA) sec 85; 1987 (WA) sec 77; 1989 (Qld) sec 100; 1990 (Tas) sec 41; 1992 (ACT) sec 50; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 95.

37. This power is analogous to similar powers that can be exercised under unconscionability legislation discussed at ¶5-730—¶5-760.

38. *Pavich v Bobra Nominees Pty Ltd* (1988) ATPR (Digest) ¶46-039; (1988) ATPR ¶40-917.

39. *Money v Westpac Banking Corporation* (1988) ATPR (Digest) ¶46-034; (1988) ATPR ¶40-894; ¶7-280.

40. *IBM Australia Ltd v National Distribution Services Ltd* (1991) 22

NSWLR 466; (1991) ATPR ¶41-094, noted at ¶1-443; ¶7-280.

41. *Demagogue Pty Ltd v Ramensky* (1993) 39 FCR 31; (1993) ATPR ¶41-203 (“off plan” unit with no road access); *Security and Equity Trading (Aust) Pty Ltd v Umtali Holdings Pty Ltd* (1995) ATPR ¶41-373.

42. *Software Integrators Pty Ltd v Roadrunner Couriers Pty Ltd* (1997) ATPR (Digest) ¶46-177; ¶5-700.

43. *Radferry Pty Ltd v Starborne Holdings Pty Ltd* (1999) ATPR (Digest) ¶46-189; ¶8-840.

44. Campbell, JC, *Contribution, contributory negligence and sec 52 of the Trade Practices Act* (1993) 67 ALJ 87 at p 92.

45. eg *Austotel Management Pty Ltd v Jamieson* (1996) ATPR ¶41-454.

The right of action found in sec 87(1A) is available independently of any other action once there has been a Part V contravention.⁴⁶

Section 87(1B) allows the ACCC to bring sec 87(1A) proceedings, on behalf of a person or persons who have been affected by conduct breaching Part V of the Act, in a representative action (comparable to those available by Consumer Affairs Bureaus or equivalents in some jurisdictions: ¶7-860).⁴⁷

The development of class action legislation is noted at ¶7-770—¶7-780.

¶8-865 Power of court to prohibit payment or transfer of moneys or other property: sec 87A.⁴⁸ To prevent funds fraudulently obtained from consumers being dissipated in the often lengthy period during which investigations are pursued to completion, proceedings instituted and judgment given, sec 87A allows the court to “freeze” the defendant’s assets on application by the Minister or the Commission where proceedings have commenced under sec 79, 80, 82 and/or 87.

¶8-866 Enforceable undertakings: sec 87B, 87C.⁴⁹ The ACCC or the Secretary of the Treasury may accept a written undertaking in relation to a matter over which it has “power or function” (sec 87B, 87C respectively).

If the applicant breaches a term of the enforceable undertaking, the ACCC or the Secretary respectively may apply to the court for an order including enforcement, payment to the Commonwealth of an amount representing any financial benefit obtained from the breach, any order of compensation to any person who has suffered loss or damage due to the breach, or any other order (sec 87B(4), 87C(4)).

¶8-870 Defences: sec 85.⁵⁰ In a prosecution for contravention of a consumer protection provision (ie not a sec 52 claim), it is a defence if the defendant shows one of the following:

- (a) that the contravention was due to reasonable mistake (¶8-880);
- (b) that the contravention was due to reasonable reliance on information supplied by another person (¶8-890); or

46. Confirmed by sec 87(1C), operative 18 December 1986, overruling the High Court in *Sent v Jet Corporation of Australia Ltd* (1986) 160 CLR 540; (1986) ATPR ¶40-704, noted (1986) 60 ALJ 642.

47. As in *Trade Practices Commission v Friendship Aloe Vera Pty Ltd* (1988) ATPR ¶40-892.

48. Also ASIC Act 1989 (Cth) sec 12GN; *Fair Trading Act 1999* (Vic) sec 154; 1987 (NSW) sec 73; 1987 (SA) sec 86; 1987 (WA) sec 78; 1989 (Qld) sec 102; 1990 (Tas) sec 42; 1992 (ACT) sec 51; *Consumer*

Affairs and Fair Trading Act 1990 (NT) sec 96.

49. Equivalent to *Australian Securities and Investments Commission Act 1989* (Cth) sec 93AA, 93A.

50. Also ASIC Act 1989 (Cth) sec 12GI; *Fair Trading Act 1999* (Vic) sec 155; 1987 (NSW) sec 71; 1987 (SA) sec 88; 1987 (WA) sec 83; 1989 (Qld) sec 97; 1990 (Tas) sec 40; 1992 (ACT) sec 49; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 94.

- (c) that (i) the contravention was due to the act or default of another person, an accident or to some other cause beyond the defendant's control, *and* (ii) the defendant took reasonable precautions and exercised due diligence to avoid the contravention (§8-900).

§8-880 Mistake or negligence: sec 85(1)(a). The defence of "reasonable mistake" for a prosecution under Part V (ie not sec 52) sets a high standard. Dictionaries state that "mistake" means an incorrect idea or opinion, an error in conduct leading to an unintended outcome, or some misconception. Neither ignorance of the law nor a mistake of law would provide a defence.⁵¹ Equally, carelessness, negligence or recklessness would not qualify as a "mistake" for the purposes of this subsection.

§8-890 Reliance upon another person's information: sec 85(1)(b). Reasonable reliance on information supplied by another person is a defence, although to maintain consistency with the strict liability imposed by sec 84 (§8-760), the Act as amended in 1986 provides in sec 85(1A) that "another person" does not refer to a servant or agent of the defendant, or, where the defendant is a corporation, a director of the corporation. For example a manufacturer of toy koalas labelled "Made in Australia" (one model of which was in fact about 40% made in Korea) was able to rely on the sec 85(1)(b) defence when prosecuted under sec 53(eb) (§7-300, §7-356) because it complied with Department of Trade, Australian Trade Commission and Austrade information.⁵²

§8-900 Another person's act or default, accident: sec 85(1)(c). A defendant may also establish that its contravention of a consumer protection provision was due to the act or default of another person, to an accident or to some other cause beyond the defendant's control, *and* that the defendant took reasonable precautions and exercised due diligence to avoid the contravention.

To be able to set up this defence the defendant must serve on the prosecuting officer, not later than seven days before the hearing, a written notice as to the identity of the other person.

— *Case example* —

In the *Mazda case* the management of the defendant company was found guilty of gross negligence in publishing advertisements which erroneously stated that certain Mazda cars had servo-assisted brakes. *Smithers J* dismissed the contentions of Mazda that its contravention of sec 53(c) (§7-330) was due to a mistake or to reliance on information supplied by or to the act or default of another person, namely the defendant's advertising agency or its

51. eg *Gilmore v Poole-Blunden* (1999) ATPR (Digest) ¶46-197.

52. *Thorp v CA Imports Pty Ltd* (1990) ATPR ¶40-996.

servants. The company's officers had failed both to verify the statements in the advertisements and to take adequate remedial action.

— *Eva v Mazda Motors (Sales) Pty Ltd*⁵³ —

¶8-910 Publisher's defence: sec 85(3). In a prosecution for a breach of Part V (including misleading or deceptive conduct) committed by the publication of an advertisement, it is a defence if the defendant establishes—

- (a) that the defendant is a person whose business it is to publish or arrange for the publication of advertisements; and
- (b) that the defendant received the advertisement for publication in the ordinary course of business *and* did not know and had no reason to suspect that its publication would amount to a breach of Part V (sec 85(3)).

— *Case example* —

The TPC prosecuted a TV station (D) for a false representation under sec 53(e) (¶7-350) for screening an offending advertisement by Metro Ford Pty Ltd. D argued that the misleading statements made in the advertisement were not its own but were those of Metro Ford. This argument "involves the proposition that the repetition of a misleading statement made by some other person is not an offence". After considering the publisher's defence under sec 85(3), the court rejected D's argument and said: "It would appear ... that by providing for such a defence the legislature recognises that an advertiser can be guilty of an offence in respect to an advertisement of other persons' goods and for repetition of a statement made originally by some other person."⁵⁴ On appeal, D similarly argued that it did not make any statement (particularly the alleged false or misleading advertisement) but only published a statement of another. This argument was accepted by the Full Federal Court and the appeal was upheld. The conviction was quashed.

— *Universal Telecasters (Qld) Ltd v Guthrie*⁵⁵ —

In contrast, the *C.P.A. case* (¶7-280) showed that because the Australian Financial Review had been notified by the Australian Society of CPAs of its trade practices complaint (that it believed the "C.P.A." membership advertisements run by the Federation of Australian Accountants were in breach of sec 52 and 53), the Review had lost its special defence under sec 85(3) and, like the Federation, was in breach of the Act.

Section 65A⁵⁶ excludes "prescribed information providers" such as the media from the operation of sec 52, 53, 53A, 55, 55A and 59 relating to misleading or deceptive conduct and misrepresentations, unless they have a

53. (1977) ATPR ¶40-020.

54. *Guthrie v Universal Telecasters Queensland Ltd* (1977) ATPR ¶40-038 at p 17,416.

55. (1978) 32 FLR 360; (1978) ATPR ¶40-062.

56. Also ASIC Act 1989 (Cth) sec 12DN; *Fair Trading Act* 1987 (NSW) sec 60; 1999 (Vic) sec 32; 1987 (SA) sec 74; 1987 (WA) sec 63; 1989 (Qld) sec 51; 1990 (Tas) sec 28; 1992 (ACT) sec 31; *Consumer Affairs and Fair Trading Act* 1990 (NT) sec 60.

commercial interest in the content of the information. For example, a newspaper will face the same responsibility for the accuracy of information as would any other person and may be liable under sec 52 if it agreed to publish a “news” item about a product in exchange for the product supplier taking out paid advertising in that publication.

¶8-920 Failure to comply with product standards: sec 85(4) and 85(5). In a prosecution for an offence committed by the supplying of goods that did not comply with a consumer product safety or information standard (¶7-495), it is a defence if the defendant (eg a retailer) shows—

- (a) that the goods were acquired for the purpose of resupply from a person who carried on in Australia a business of supplying such goods otherwise than as the agent of a person outside Australia, *and*
- (b) that the defendant did not know, and could not have determined, that the goods did not comply with that standard, or that the defendant relied in good faith on a representation by the person from whom the defendant acquired the goods that there was no product safety or information standard in respect of the goods.

¶8-930 Good faith defence: sec 85(6). In proceedings against a person *other than a body corporate* for contravening a provision of Part IV (Restrictive Trade Practices) (¶8-030) or for attempting, or being involved in, a contravention of such a provision (sec 76), if it appears to the court that the person acted honestly and reasonably and should be excused, the court may relieve the person from liability to any penalty or damages (sec 85(6)).

Chapter 9

Business Organisations

FORMS OF BUSINESS ORGANISATION	¶9-010—¶9-020
SOLE TRADER	¶9-030—¶9-120
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FORMS OF BUSINESS ORGANISATION _____

Choice of business structure ¶9-010

The evolution of organisational forms ¶9-020

¶9-010 Choice of business structure. People wishing to commence a business have a variety of questions to consider before deciding to launch the venture. Chief among these questions is, which business organisation provided by law should be adopted for the venture: sole proprietorship? partnership? joint venture? company? co-operative? association? trust? franchise? A number of factors have to be considered, including:

- The purpose of the business.
- Its duration.
- The cost and method of formation, ie whether the procedure is simple or elaborate.
- Availability of capital at both the initial and subsequent stages.

¶9-010

- Whether the sources of capital can be relied upon for both the working and any additional capital required as the business expands.
- The type of assets which the venture will acquire.
- The authorised subscribed and paid up capital that the venture should have initially and the proportion of working capital which should be provided by way of capital or loan.
- Whether the venture should be purchased already established or started from scratch.
- The powers of control which should be invested in the promoters and in later participants.
- The selection of key personnel.
- Whether provision should be made for division of voting power among different participants.
- Whether minors could become members.
- Who should be entitled to participate in income distributions.
- Who should be entitled to participate in capital distributions.
- Whether there should be provision for variation of the structure and entitlements.
- The taxation advantages and disadvantages of the various structures.
- Whether the structure should be set up in Australia or overseas, or in one particular State or Territory, having regard to its probable activities and to tax considerations.
- The function of the members of the group, ie whether each member should be allowed to act for and bind the unit, or whether the management should be vested in a group selected by them.
- Whether members' interests should be transferable.
- Whether the venture should be independent of the members, with a capacity to sue and be sued, obtain title to property, etc, or whether legal liability should be directly attached to the names of all the members.
- The provision for expansion of the business.
- The probable requirements of lending institutions.

The ultimate decision about the form the business will take will rest with the person or group, usually after advice from lawyers, accountants and other business advisers on the practical and legal possibilities. The High Court has repeatedly stated that the choice of a suitable business structure is not limited and that where the *Income Tax Assessment Act* contemplates alternative structures, the taxpayer has the freedom to choose the business structure which best suits the taxpayer's own purposes. This chapter¹ compares seven main forms of business organisation according to ten points of comparison, as tabulated.

1. Drawing on Appendix 2 of Betts, RW, Buchanan, RF and Baxt, R, *Corporate*

Trustees, CCH Australia Limited, 1979, pp 115-121.

BUSINESS ORGANISATIONS: COMPARATIVE TABLE

POINTS OF COMPARISON	SOLE PROP- RIETORSHIP	PARTNERSHIP	JOINT VENTURE	INCORPORATED COMPANY	ASSOCIATION	TRUST	FRANCHISE
NATURE OF STRUCTURE	¶9-030	¶9-130	¶9-140—¶9-180	¶9-270—¶9-350	¶9-630	¶9-750—¶9-810	¶9-985
GOVERNING LAW	¶9-040	¶10-010, ¶10-020 ¶10-050—¶10-150	¶9-190	¶9-370, ¶9-380	¶9-630	¶9-820	¶9-986
ESTABLISHMENT	¶9-050	¶10-020	¶9-200	¶9-390—¶9-440	¶9-650	¶9-830—¶9-840	¶9-987
CONTINUITY OF EXISTENCE	¶9-060	¶10-360	¶9-210	¶9-450	¶9-660	¶9-870	¶9-990
LIMITATION OF LIABILITY	¶9-070	¶10-190, ¶10-360	¶9-220	¶9-460	¶9-670—¶9-700	¶9-885—¶9-900	¶9-991
CONTROL	¶9-080	¶10-430	¶9-230	¶9-470	¶9-710	¶9-905—¶9-930	¶9-992
FORMALITIES/ ADHERENCE TO SPECIFIC DATES	¶9-090	¶10-020, ¶10-030, ¶9-090	¶9-090 ¶9-230	¶9-490—¶9-570	¶9-715	¶9-940	¶9-995
ADMISSION OF NEW INVESTOR/ PARTICIPATOR INTO SCHEME	¶9-100	¶10-360, ¶10-430, ¶10-480	¶9-240	¶9-580	¶9-720	¶9-950—¶9-960	¶9-996
ABILITY TO SELL ENTIRE BUSINESS INTEREST	¶9-110	¶10-480	¶9-250	¶9-590	¶9-730	¶9-970	¶9-996
CESSATION OF BUSINESS	¶9-120	¶10-490—¶10-630	¶9-260	¶9-600—¶9-626	¶9-740	¶9-980	¶9-997

The forms of organisation discussed are:

- sole proprietorship,
- partnership,
- joint venture,
- company,
- association,
- trust,
- franchise.

The ten points of comparison are:

- (1) Nature of structure.
- (2) Governing law.
- (3) Establishment.
- (4) Continuity of existence.
- (5) Limitation of liability.
- (6) Control.
- (7) Formalities/adherence to specific dates.
- (8) Admission of new investor/participator into scheme.
- (9) Ability to sell entire business interest.
- (10) Cessation of business and winding up.

¶9-020 The evolution of organisational forms. The chief characteristic of these business organisations is that they are formed mainly for the gain, usually but not necessarily financial, of either the organisation or its members. They help provide an identifiable entity for the trader and also allow the submerging or blending of the trader's personality with the business personality.

These forms of business organisation differ from each other in many ways. In a sense sole proprietorship, partnership and incorporation represent the evolutionary stages of the growth of a small one-person concern to a bigger business organisation. Indeed, five possible phases of a business organisation might be:

- (1) The founder begins as a single trader or in partnership.
- (2) Then the trader converts the business into a proprietary company and expands it.
- (3) Then the proprietary company is transformed into a public company, creating the conditions for obtaining finance from the public.
- (4) The public company is then admitted to quotation at the stock exchange (¶9-350) and an issue of shares (¶13-430) or debentures (¶13-480) is made.

- (5) Later the public company develops into a group of companies which has subsidiaries locally and abroad.

The remainder of this chapter comprises a brief comparison of the characteristics of each of these forms of business organisation under various sub-headings relating to their nature and characteristics.

SOLE TRADER

Nature of structure	¶9-030
Governing law	¶9-040
Establishment	¶9-050
Continuity of existence	¶9-060
Limitation of liability	¶9-070
Control	¶9-080
Formalities	¶9-090
Admission of new investor/participator	¶9-100
Ability to sell entire business interest	¶9-110
Cessation of business	¶9-120

¶9-030 Nature of structure. There are few formalities for one person — such as a retailer, repairer or farmer — to set up business as a sole trader or sole proprietor. However, there are limitations on sole proprietorship:

- Limited life — if the trader dies the business may come to an end.
- Limited access to finance if the business grows — a sole trader cannot raise finance from the public and is limited to everyday sources such as finance companies, mortgages of property, etc, discussed in Chapter 13.
- Unlimited liability — if the trader incurs a business debt a creditor will have a right of claim against the trader's personal assets, such as the family house or any other personal or business assets.

¶9-040 Governing law. There is no statutory regulation of the sole trader per se in view of the sole trader's status as a one-person business organisation. The sole trader will be subject to normal business regulation in the same way as all other business organisations. The trader will have to be alert to numerous areas of legal regulation — tax law and tax planning, trade practices law, misleading or deceptive conduct (¶7-250) and the conditions that are implied into any contract of sale (¶7-035), health and safety law, workers' compensation, public liability insurance, industrial law requirements, local council by-laws, environmental, pollution and noise control laws, to name but a few.

¶9-050 Establishment. Establishment for a sole trader need not involve questions such as those just raised: it may involve no more than parking alongside a busy highway with a boot full of cut flowers, buckets,

¶9-030

water and a sign reading FLOWERS. At a higher level of business sophistication there may be an entry in the phone book and/or creation of a web page. Establishment does not necessarily involve the same formalities as meet the promoters of the other business organisations under consideration in this chapter.

¶9-060 Continuity of existence. The fact that on the trader's death the business will also die is one of the disadvantages of operating a business through the personal medium of sole proprietorship. On the other hand, if the business is personal in orientation and style, the ending of the business with its proprietor may well be appropriate in the circumstances.

¶9-070 Limitation of liability. Liability is unlimited and creditors will have recourse against all assets of the sole trader held in the sole trader's name. This includes, in addition to business assets (plant and equipment), personal assets (house and car). One method of softening the rigours of unlimited personal liability is through the protection afforded by public liability or professional indemnity insurance, without which no business should operate (¶17-050).

¶9-080 Control. No problem of control by outside influences arises unless the sole trader is under the influence of market pressures or other external forces. On the other hand, there is no one to share the responsibility for business decisions or to contribute a variety of business expertise.

¶9-090 Formalities. Governmental administration — “bureaucracy” and “red tape” — will give rise to some of the formalities facing the sole trader. The primary formalities which must be carried out by a sole trader are registration under the *Business Names Act* (Chapter 12) where it is proposed that the business be carried on under a name which is different from the name of the proprietor, and registration for an Australian Business Number (ABN) and for GST with the Australian Taxation Office. In addition, tax return time and other deadlines will never be far from the business mind. Specific dates will include dates for payments — licences, tax, local government, insurance, finance, leases, etc. However, none of the formalities involved in company administration created by the company's artificial status as a legal entity will be relevant in the administration of non-corporate structures.

The above comments apply equally to partnerships, joint ventures, and unincorporated associations. Partnerships must file a partnership tax return, though joint ventures as such are not required to. Unincorporated clubs and associations which are not partnerships are treated as companies for taxation purposes, but certain associations and clubs (eg trade unions and employer and employee associations) are specifically exempt from income tax.²

2. See *Australian Master Tax Guide*, CCH Australia Limited (current edition).

¶9-100 Admission of new investor/participator. There are no legal restrictions per se to prevent a sole trader from bringing new investors or participators into the business. With no one to answer to, the business can be tailored to suit current activities. Restrictions may be encountered from certain quarters — for example, a professional association may prevent the amalgamation of a professionally qualified sole trader and an unqualified person (see ¶10-020). A lender may claim over the sole trader's assets by way of a floating charge (see ¶13-480), and may have the legally enforceable right to be notified of any impending change in the business. In addition, a lender's consent to changes may be required. Changes in the nature of the business affecting the insurance risk should also be notified to the sole trader's insurers.

¶9-110 Ability to sell entire business interest. The sole trader's ability to sell the business will not depend on organisational legalities, and the crucial factor will always remain the saleability of the business itself.

¶9-120 Cessation of business. Because the sole trader is the person who owns and conducts the business in question, any decision to close the business will be that of the sole trader. Although there are no shareholders to answer to for such a decision, a number of persons or organisations may take some interest in any proposals for the cessation of the business, such as the sole trader's creditors, suppliers, competitors, or family.

PARTNERSHIP

¶9-130 Nature of structure. The term "partnership", like the terms "company" and "firm", is used loosely. In contrast to a company, however, a partnership can be of an informal nature. The only real test is whether the parties actually are in fact "carrying on a business in common with a view of profit", as defined in the *Partnership Act* (see ¶10-050). Unlike a company, a partnership is not a separate legal entity; for instance, a partnership does not pay tax (although it does lodge a tax return) and tax is paid by the individual partners in their own returns.

Yet the law does in some limited ways treat a partnership as if it were a separate legal entity. In the first place the rules of the Supreme Court of the various jurisdictions recognise that it would be extremely difficult, if not impossible, for litigation to be brought by members of a firm or against members of a firm (or partnership) unless a certain degree of flexibility were introduced into the procedures. This has been done in all of the jurisdictions through amendments to the Rules of Court which enable representative actions to be brought by and against partnerships (or members of a firm in the appropriate circumstances) (¶10-260). Furthermore, legislation is in place in all jurisdictions (¶12-010) enabling registration of a business name, or name for the firm, and permitting the partnership to trade in that fashion. In consequence, the partnership structure — ie the commercial enterprise — is generally treated by the law as though it were an entity or a person.

¶9-100

Partnership is a fairly common form of business organisation, and its popularity is largely due to both the simplicity of forming a partnership and flexibility in carrying on the business. For example, if the partners all agree, they can change the nature of the business at their own convenience, effect a change in their entitled share to profit, or any other matters within the scope of the partnership.

Its advantage over sole proprietorship is that it usually has the combined financial resources of the partners plus the accumulated experience of more than one person. Except in the case of a limited partnership (§10-190), partners face unlimited personal liability. Examples of partnerships range from mega-firms of accountants with up to 1,000 members to the local fish and chip shop run by a husband and wife partnership (§10-020). The law of partnership governing each of these businesses is the same.

Partnership is discussed in detail in Chapter 10. See the table in §9-010 for a key to enable comparison with the other structures discussed in this chapter.

JOINT VENTURE

Nature of structure	§9-140
Joint venture distinguished from partnership	§9-150
Joint venture distinguished from syndicate	§9-160
When joint ventures are used	§9-170
Advantages of joint ventures	§9-180
Governing law	§9-190
Establishment	§9-200
Continuity of existence	§9-210
Limitation of liability	§9-220
Control/formalities	§9-230
Admission of new investor/participator	§9-240
Ability to sell entire business interest	§9-250
Termination of venture	§9-260

§9-140 Nature of structure. A joint venture is a commercial combination in common by way of contract for the individual gain of the parties generally confined to a particular undertaking.³ More formally put:⁴

“A joint venture is an association of persons, natural or corporate, who agree by contract to engage in some common, usually ad hoc undertaking for joint profit by combining their respective resources, without, however, forming a partnership in the legal sense (of creating that status) or corporation; their

3. eg Duncan, WD (ed), *Joint Venture Law in Australia*, Sydney, Federation Press, 1994.

4. Williston, S, *A Treatise on the Law of Contracts*, Baker, Voorhis & Co Inc, 3rd

ed, 1959, Vol 2, pp 555-556 (footnote omitted), approved in *Brian Pty Ltd v United Dominions Corporation Ltd* [1983] 1 NSWLR 490 at p 506; cf partnership definition §10-050.

agreement also provides for a community of interest among the joint venturers each of whom is both principal and agent as to the others within the scope of the venture over which each venturer exercises some degree of control."

Essentially, a joint venture involves separate ventures for each of the parties, participants, joint venturers, or co-venturers. Assets of the joint venture are usually owned by the participants as tenants in common (¶13-160) with each party having an individual share. The parties have a right to receive their share of income and to separately dispose of it. Indeed, separate invoices are often issued, and paid by the joint venturers individually. In the words of one commentator, "[t]he joint venture is something other than a partnership. The activity of a joint venture is joint but little else is intended to be joint".⁵

Whether the relationship between joint venturers is a fiduciary one (¶9-770) will depend upon the form which the particular joint venture takes and upon the content of the obligations which the parties to it have undertaken. If the joint venture takes the form of a partnership, the fact that it is confined to one joint undertaking as distinct from being a continuing relationship will not prevent the relationship between the joint venturers from being a fiduciary one. Further, in such a case, the fiduciary relationship (with its attendant obligations and duties) can arise before the precise terms of any agreement have been settled. These last two points are illustrated in the following cases.

— Case examples —

Brian Pty Ltd (B), United Dominions Corp Ltd (UDC) and others had been joint venturers in a successful shopping centre development, negotiated in September 1973 and formally agreed to in July 1974. One of the joint venturers, Security Projects Ltd (S), owned the joint venture land. In October 1973, S mortgaged the land to UDC under a mortgage containing a "collateralisation clause". That clause purported to charge the joint venture land with repayment of all amounts owing by S to UDC whatsoever. Its effect was to charge the land with indebtedness incurred by S in transactions with which B had nothing to do. B did not know of the existence of the collateralisation clause. In November 1973 and September 1974, S mortgaged some of its other land to UDC by documents containing the same collateralisation clause. Upon later default by S, UDC claimed that it was entitled to retain the surplus proceeds of sale of the shopping centre to apply them in reduction of the amounts owing by S. As a result, B received neither repayment of its contribution nor its agreed share of the profits on its joint venture investment of \$88,000. In an action by B for its share, the High Court unanimously held that although described as a joint venture, the arrangement between the parties was in reality a partnership. Further, a fiduciary relationship may arise during negotiations for a partnership (or a joint venture) before any partnership or joint venture agreement has been formally concluded if the parties acted upon the proposed agreement. In the present case the relationship between UDC, S and B had assumed a fiduciary character before S gave the first mortgage to UDC. UDC and S had breached

5. Chetwin, MC, *Joint ventures — a branch of partnership law?* (1990) 16 UQLJ 256 at p 271.

their fiduciary obligations to B and therefore B was entitled to its share of the joint venture profits.

According to *Mason, Brennan and Deane JJ*:

“A fiduciary relationship can arise and fiduciary duties can exist between parties who have not reached, and who may never reach, agreement upon the consensual terms which are to govern the arrangement between them. In particular, a fiduciary relationship with attendant fiduciary obligations may, and ordinarily will, exist between prospective partners who have embarked upon the conduct of the partnership business or venture before the precise terms of any partnership agreement have been settled. Indeed, in such circumstances, the mutual confidence and trust which underlie most consensual fiduciary relationships are likely to be more readily apparent than in the case where mutual rights and obligations have been expressly defined in some formal agreement. Likewise, the relationship between prospective partners or participants in a proposed partnership to carry out a single joint undertaking or endeavour will ordinarily be fiduciary if the prospective partners have reached an informal arrangement to assume such a relationship and have proceeded to take steps involved in its establishment or implementation.”

_____ *United Dominions Corporation Ltd v Brian Pty Ltd*⁶ _____

The Dickson Hotel. P and D entered an agreement for the redevelopment of the Dickson Hotel, owned by D's company, and each agreed to pay 50% of the development costs. As a result of their joint efforts, the appropriate government authority gave approval for a major redevelopment which had the effect of increasing the value of the property by some \$440,000 net. However, P and D had a falling out over how the agreement was to proceed, and D sold the property and retained the proceeds. P successfully sued for his equal half-share on the basis that the parties had entered a contract of future partnership (ie a partnership conditional upon approvals being gained and upon the viability of the project). At this stage there was no partnership, but the parties' relationship was held to be that of joint venturers. In line with the *Canny Gabriel case* (§13-048), *Chan v Zacharia* (§10-570) and the *Brian case* above, they were under a fiduciary obligation to share the benefits arising from their joint activity.

_____ *Ravinder Rohini Pty Ltd v Krizaic*⁷ _____

Where such a fiduciary obligation exists it includes the obligation to disclose any interest adverse to the common interest such as the granting of a mortgage over joint venture land or the granting of a security by way of a charge (§13-048; §13-540) on the assets of the joint venture. These obligations will rank ahead of the interests of one or more of the other joint venturers. Such arrangement may be voidable at the option of the other joint venturers.

§9-150 Joint venture distinguished from partnership. A joint venture may qualify as a partnership if it fulfils the partnership tests of “business in common with a view of profit” (§10-050), although Australian

6. (1985) 157 CLR 1; (1985) 59 ALJR 676. 7. (1991) 105 ALR 593.

courts are likely to hold that the typical joint venture is not a partnership. There are at least four differences between joint ventures and partnerships:⁸

- (1) Although participants in a joint venture hold in common their interests in the assets committed to the venture, their liability is individual (“several”).
- (2) A manager or operator is often interposed between the participants and the operation, and they have no authority to bind one another as agents (cf partners: ¶10-210).
- (3) Participants can dispose of their interest in the joint venture (subject to the terms of the agreement), whereas partners are only able to assign their partnership interest within the scope of the *Partnership Act* (¶10-480).
- (4) The participants receive their share of the profits separately and sometimes in kind.

The contrast between a joint venture and partnership was highlighted in the *Canny Gabriel case*, which had to decide whether what the parties called a “joint venture” was a partnership, and if so, whether a partner could recover payments made to a third party by fourth parties.

— *Case example* —

P1 (the promoter—Fourth Media) contracted with pop stars Cilla Black and Elton John to tour Australia in 1971. P1 then contracted with P2 (the financier—Volume Sales) that in consideration of an advance from P2, P1 agreed to assign to P2 a “one half interest in the contracts and to perform the said contracts as a joint venture”. The advance was described as a “loan to the joint venture”, and was repayable before the distribution of profits. The agreement did not mention partnership, but net profits were to be divided at the end of the contract and all policy matters were “to be agreed by the parties”. A bank account was to be opened for the venture in the name of P2. If the contract should “fail”, the advance was to be repaid to P2 “without deductions”—ie losses were not to be shared on the same basis as profits (¶10-110). Any differences were to be settled by arbitration (¶1-443).

As security for more finance, P1 granted an equitable charge (¶13-048) the next day to TP (Canny Gabriel) over its “undertaking and property”, including its interest in the box office proceeds.

When P2 sued TP to recover some of the box office receipts which TP had collected, two issues were confirmed by the High Court:

- (1) The joint venture was legally a partnership between P1 and P2 because the tests of partnership were fulfilled (¶10-050ff) and because the profits were to be shared (¶10-100).

8. Merralls, JD, *Mining and petroleum joint ventures in Australia: some basic legal concepts* (1988) 62 ALJ 907 at pp 908-912; Lehane, JRF, *Joint venture finance and some aspects of security and recourse*,

in Austin, RP and Vann, R, (eds) *The Law of Public Company Finance*, Sydney, The Law Book Co Ltd, 1986, pp 516-517.

- (2) The court ordered the box office receipts collected by TP to be paid to P2. Because partners have an *equitable interest* in property owned by the partnership (§10-390), the equitable interest of P2 in the box office receipts would take priority over the *mere equity* of TP (§3-210). Unless the partnership were being wound up—where priority would be given to creditors like TP (§10-630) — TP had no right to immediate repayment of its loan.

————— *Canny Gabriel Castle Jackson Advertising Pty Ltd v
Volume Sales (Finance) Pty Ltd*⁹ —

¶9-160 Joint venture distinguished from syndicate. A joint venture may also be distinguished from a syndicate. A syndicate may well involve fewer common interests between the parties than would normally be seen between joint venturers. However, the aim of a syndicate is also to ensure that profits are made and that they are shared in appropriate ways.

— *Case example* —

A syndicate was formed to acquire a submarine. In order to turn it into a profit-making venture, the members decided to renovate the submarine and to make it available for public inspection at a fee. An arrangement was entered into between the syndicate and the Port Jackson and Manly Steamship Company under which the submarine was kept at a wharf belonging to the company. Shortly afterwards a storm broke in Manly Cove where the submarine was moored, and the submarine became dangerous to the wharf. The steamship company engaged a tug company to tow the submarine into more open waters for the protection of the submarine and the wharf. During the towing operations the submarine broke loose and was wrecked.

A question was, who was responsible for the damage or loss sustained as a result of the destruction of the submarine? This required the court to consider a number of possibilities. It was suggested that the arrangement was merely one of lessor and lessee — the syndicate leased the wharf space from the steamship company. Another suggested relationship was that of principal and agent — the steamship company was appointed as agent to manage the submarine which belonged to the syndicate. The syndicate, on the other hand, argued that a partnership had been created because there was a sharing of the profits between the two parties, namely the syndicate and the steamship company. The court eventually held that there was no partnership in this case — at best there was a syndicate or licensing arrangement.

————— *Beckingham v Port Jackson and Manly Steamship Company*¹⁰ —

Members of a syndicate may, however, have the status of partners at general law according to the tests in the *Partnership Act* (§10-060ff) and in

9. (1974) 131 CLR 321; (1974) 48 ALJR 217; noted (1974) 48 ALJ 417; §10-070; §10-110; joint venture in *Connell v Bond Corporation Pty Ltd* (1992) 8 WAR 352, similarly analysed as a partnership.

10. (1957) 57 SR (NSW) 403.

addition may be assessed as partners under sec 92 of the *Income Tax Assessment Act 1936*.

¶9-170 When joint ventures are used. The following situations are some of those in which the joint venture form of organisation could be useful:¹¹

- (1) mining syndicates;
- (2) property developments;
- (3) manufacturing arrangements;
- (4) publishing arrangements;
- (5) entertainment agreements;
- (6) industrial research and development agreements;
- (7) sharefarming arrangements.

There is an infinite variety of sharefarming arrangements that can occur, for example. Sharecropping arrangements work in very similar ways to dairying arrangements. Most agreements will provide for the farmer to contribute labour and some equipment, while the capital comes from the “silent” venturers.¹² In each of these situations, however, both the owner and the farmer will be engaged in the business of primary production and will thus be able to take advantage of the averaging provisions of the *Income Tax Assessment Act*.

¶9-180 Advantages of joint ventures. Joint ventures have certain advantages over partnerships:¹³

(1) The joint venturer is not responsible for the acts of co-venturers. The relevant *Partnership Act* provisions (see ¶10-200—¶10-360) would not apply (unless the joint venture were in fact a partnership: ¶9-150). There is a greater degree of control over the actual expenditure by co-venturers than in the case of partnerships.

(2) Under the terms of the *Income Tax Assessment Act* the joint venturer's share of the actual assets of the joint venture and share of the expenditure incurred on the joint venture are brought directly into its accounts, not as a share in the common fund, but individually. This enables each joint venturer to determine its own method of treating expenditure, valuing shares and, in particular, its own attitude as to what elections should be made under the Act. This is particularly relevant in the mining area. Division 330 of the *Income Tax Assessment Act 1997* now deals specifically with mining and quarrying.

11. Noted by Walsh, MJ, *Partnerships — Joint Ventures and Taxation* (1978-79) 13 TIA 478 at p 488.

12. cf ¶10-160, silent partners.

13. See Walsh, *op cit*, pp 485-486.

- (3) The joint venturer can dispose of its share of the product in any chosen manner, subject to any special arrangements.
- (4) Generally speaking, a transfer or an assignment of the rights of a party to a joint venture can take place without consent. This is especially relevant if the transferor is a bona fide prospector — see sec 330-60 of the *Income Tax Assessment Act 1997*.
- (5) Where the joint venturers do not owe the same degree of confidence and mutual trust to their co-venturers as they would if they had an arrangement similar to a partnership,¹⁴ the joint venturers may be able to compete with each other in some circumstances.
- (6) In some cases where the joint venturer is a foreign corporation it may enjoy particular benefits under its own domestic tax laws, in relation to depreciation or other allowances, especially where investment in the mining industry is involved, which may not occur where a joint venture is properly regarded as a partnership so that its interest is not to be regarded as an interest in any actual asset. Moreover, the expenditure may be seen as an investment, not as a deductible expense.
- (7) While partners are capable of being sued and can sue in the firm name under the Rules of Court of the various States and Territories (see ¶9-130), the joint venture is not recognised as a “quasi-entity or firm”. This gives a measure of protection against being joined in actions. However, contribution may well be sought in appropriate cases by the co-venturers.

There will be other advantages, depending on the nature of the joint venture arrangements that exist between the parties. This will depend not only on the tax advantages, but also on advantages that may be given as a result of specific legislation in different States and in different professions.

¶9-190 Governing law. The business use of the term “joint venture” fails to take into account the various methods of collaboration forming the joint venture. Analysis of the exact legal form of the collaboration will indicate the applicable governing law — whether it be a pure application of contract law, or a combination of security law and contract, or a combination of company law and contract.

The primary governing law will be the law regulating the area of the joint venture, whether it be mining law, land law or any of the other areas where joint ventures are common (mineral exploration, extraction industries, the construction industry, manufacturing industry and real estate development).

A joint venture may have the legal status of a partnership if the partnership definition sections of the Partnership Acts are fulfilled (¶9-150; ¶10-050ff);

14. Some joint ventures may include fiduciary obligations between the co-venturers: see ¶9-140.

but, "A joint adventure is not necessarily a partnership".¹⁵ If the joint venture does constitute a partnership, the governing law will include partnership law (as discussed in Chapter 10).

¶9-200 Establishment. There is no requirement under statute, or at common law, for a joint venture to be registered as such for it to come into existence, apart from the formalities imposed by business names legislation (see Chapter 12). There is no legal need for any written documentation — apart from the contractual considerations noted at ¶5-030 — although it would be very unwise to operate without a clearly defined set of conditions governing such matters as the absence of agency, rights of creditors and to which property, and proportionate shares of the venture.

¶9-210 Continuity of existence. A joint venture has a much more personal nature than some business structures, because it can exist merely by virtue of the carrying on of business; if the business is no longer carried on, that is good reason for the venture to cease.

A joint venture is not a separate legal entity, and the retirement of any joint venturer may end the venture — subject to provisions to the contrary in the partnership agreement, if the joint venture is also a partnership (¶10-500). This need not have any significant effect if the remaining venturers wish to continue the relationship with a reconstituted membership; but such changes in membership can present problems to outside parties dealing with those remaining — is the former member liable for contracts of the joint venture made while he was a member?¹⁶

A number of factors that would have no effect on a company will lead to the dissolution of a joint venture. If the venture is a partnership, subject to any agreement between the partners to the contrary, bankruptcy or death of a partner will dissolve it (¶10-520). Any partners charging their share of partnership property for their separate debts will lead to the dissolution of a partnership (¶10-520). Illegality of the business of the partnership will have the same effect (¶10-520). Insanity and other incapacity will also be grounds for dissolution (¶10-530), because they lead to contractual incapacity, as noted in ¶5-510ff.

¶9-220 Limitation of liability. Members of a joint venture are under a joint and several liability for all the debts of the joint venture, unless they have made an agreement to the contrary.¹⁷ Where the venture is a

15. Joske, P, *The Law of Partnership in Australia and New Zealand*, 2nd ed, 1966, p 40. See also Gower, LCB, *Pollock on the Law of Partnership*: Stevens, 15th ed, 1952, p 8: "I do not find that the incidents of a 'joint venture', as far as it extends, can be distinguished from those of partnership; but, whatever the importance

of the distinction may be, it is not met with in the English authorities."

16. In partnership law, yes, unless there is an agreement to the contrary: ¶10-360.

17. ¶10-250—¶10-260 where the venture is a partnership. See also *Bankruptcy Act 1966* (Cth) sec 110.

partnership, a debt contracted by one partner can be enforced by the creditor against any of the other partners. The partner known to be well endowed with worldly possessions could be made the obvious target for the creditor. Rules of Court — noted at ¶9-130 — which provide for actions against the firm in the firm name, go some way to alleviating the possible harshness of this rule. The effect of the rule is to give some legal recognition to the firm as a legal entity for the purpose of suing. The firm is, of course, not a separate legal entity as is a company.

Where the venture qualifies as a partnership, each partner is an agent of all the others, and acts done in “carrying on in the normal way business of the kind carried on by the firm” will bind the partners (¶10-200—¶10-230). All the partners will be responsible to outsiders for the acts of an errant partner unless the outsider knows of any limitation placed on the partner’s authority (¶10-200—¶10-210). Any attempt to restrict liability of the partners to partnership funds by a clause in the partnership agreement will be ineffective, even if known to creditors, unless a specific agreement to that effect is made with the creditor concerned.

¶9-230 Control/formalities. If the joint venture qualifies as a partnership, both control and management are vested in all the partners, both by the usual form of partnership agreement (“each partner shall be just and faithful to the other and shall diligently attend to the partnership business and devote his whole time and attention thereto”), and by the Act (“[e]very partner is an agent of the firm and his other partners for the purpose of the business of the partnership” (¶10-200—¶10-210); “[e]very partner may take part in the management of the partnership business” (¶10-430)).

A joint venture agreement will often provide that power to control the joint venture be placed in a management committee representing the joint venturers (like a company’s board of directors) under a manager or operator. As set out by Merralls,¹⁸ the rights and responsibilities of the operator include:

- management of the operating fund contributed and property held by the joint venturers;
- entering into third party contracts including contracts of employment; and
- the exercise of a duty of good faith to the joint venturers (¶9-140; ¶9-770).

The question of formalities and adherence to specific dates is dealt with in ¶9-090.

¶9-240 Admission of new investor/participant. In the case of a joint venture, the admission of a new participant will be a matter for agreement between the joint venturers, and will either have been provided

18. Merralls, *op cit*, pp 916-920.

for in their arrangement or will be provided for if and when the need arises. If the joint venture qualifies as a partnership, the *Partnership Act* sections noted in ¶10-430 and ¶10-480 will apply.

¶9-250 Ability to sell entire business interest. The position of joint ventures can be read in the light of the partnership experience, but the actual agreement between the parties will always provide the determining factor. If the joint venture qualifies as a partnership, the discussion in ¶10-370—¶10-480 will be relevant.

¶9-260 Termination of venture. Because a joint venture is usually entered into for a specific time — usually determined by the parties in advance — there may be no difficulty in terminating the joint venture if such matters as joint venture property, and priority with respect to payment of debts, are clearly dealt with in the joint venture agreement.

The agreement will also usually set out procedures for default. Ideally, these are designed to preserve the venture by adjusting the rights of the joint venturers. Accordingly, they include the right of the joint venturers to purchase the interest of a defaulting venturer, and the dilution of a defaulter's interest (with a corresponding increase to the others) under a pre-specified formula.

INCORPORATED COMPANY

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¶9-270 Nature of structure. The word “company” in legal theory implies an association of a number of people for some common object or objects, which can vary from such aims as staging a play to mining for uranium. However, in common usage the word “company” means those associated for economic purposes, ie to carry on a business for profit, and covers (in addition to companies in the strict legal sense) partnerships, trusts, unincorporated associations, clubs, and to some extent almost any business operation operating as “the company”.

The act of becoming a company, in the formal legal sense, is called incorporation or registration. The consequences of incorporation are partly spelt out in the Corporations Law:

“A company comes into existence as a body corporate at the beginning of the day on which it is registered. The company’s name is the name specified on the certificate of registration.” (sec 119)

Upon registration a company becomes a separate legal person. The Acts Interpretation Acts¹⁹ state that “person” includes a body politic or corporate as well as an individual (or “natural” person). A company can enter its own

19. *Acts Interpretation Act 1901* (Cth) sec 22(a); *Interpretation of Legislation Act 1984* (Vic) sec 38; *Interpretation Act 1987* (NSW) sec 21(c); *Acts Interpretation Act 1954* (Qld) sec 36; *Acts Interpretation Act 1915* (SA) sec 4; *Acts Interpretation Act*

1931 (Tas) no equivalent, but cf sec 35; *Interpretation Act 1984* (WA) sec 5; *Interpretation Act 1967* (ACT) sec 14; *Interpretation Act 1978* (NT) sec 19. See also ¶2-220.

contract (even between itself and the natural persons who set it up); it can enter a partnership with another company or with the persons who set it up. It can sue and be sued, and so on. This separate legal existence gives rise to the advantages of the corporate structure for commercial purposes.

Companies incorporated under other legislation. Although this chapter deals only with incorporation under the Corporations Law, companies can be incorporated under a Royal Charter,²⁰ or under special Acts of Parliament.²¹ These two means of incorporation are very rare.

Building societies, credit unions and friendly societies. By agreement between the Commonwealth and State governments, all financial institutions came under the supervision of three Commonwealth regulators on 1 July 1999 — the Australian Securities and Investments Commission (ASIC: ¶9-380), the Australian Prudential Regulation Authority (APRA: ¶17-035) and the Reserve Bank of Australia. Building societies, credit unions and friendly societies are now deemed to be registered as companies under the Corporations Law.

Co-operatives.²² A co-operative is a vehicle for co-operation between people, often enabling the small operator to get the benefit of economies of scale.

The principles underlying “co-ops” are different from the principles underlying corporations, as they focus on the provision of goods or services to members, rather than a financial return on members’ capital.

Co-ops are not suitable for speculative investment but are more suitable for long term investment by persons with an interest in the goods or services provided. Co-ops provide an important means for members to obtain limited liability.

Co-ops tend to fall into three categories:

- trading co-ops — to carry on a business, trade or industry;
- rural co-ops — to provide common supply, distribution and service functions; and
- community advancement co-ops — to pursue community based objectives such as recycling, housing or environmental protection.

20. The Queen of Australia still has the power, deriving from the Crown’s power to grant monopolies, to incorporate corporations by letters patent, that is, by charter.

21. eg the Australian Stock Exchange Ltd is incorporated under the *Securities Industry Act 1980* (Cth) Pt IIA (sec 36A—36K), which is “saved” by *Corporations Act 1989* (Cth) sec 81.

22. The *Co-operatives Act 1996* (Vic) was passed in 1995 as the basis for State-

based but nationally consistent co-operatives legislation, along the lines of the former co-operative scheme for companies and securities (¶9-370), and the Consumer Credit Code (¶14-080). Existing State and Territory co-operatives laws are to be replaced with uniform legislation, such as the *Cooperatives Act 1997* (Qld) and the *Co-operatives Act 1997* (SA).

Trading and rural co-ops are more than just commercial trading entities.

In some jurisdictions, co-ops must operate under the principles of the International Co-operative Alliance.²³ These principles have not changed much since the Rochdale Society of Equitable Pioneers first adopted similar ideals in Lancashire in 1844. They are important to the operation of a co-op, and show how a co-op is different from a corporation:

- (1) voluntary and open membership — membership is available to all persons who wish to be active in the co-op, with no artificial restrictions;
- (2) democratic control — members each have one vote and are entitled to participate in issues affecting their co-op;
- (3) limited interest on capital — this is currently limited to 16% per annum;
- (4) equitable division of surplus — distributions cannot be made in such a manner that one member gains at the expense of others;
- (5) co-op education — a co-operative must provide its members, officers, etc with education on the principles of co-ops;
- (6) co-operation — co-ops must co-operate with each other.

Co-ops: equity raising. Some co-ops face difficulties in equity raising because the requirement of “one member, one vote” imposes limitations on capital raising. In addition, members are required to be active in the co-op and this requirement significantly limits the marketability of shares. Even very large trading co-ops have no ready market for their shares.

This problem has been addressed to some extent in New South Wales, for example, through the creation of hybrid debt/equity instruments called co-operative capital units (CCUs). CCUs have attributes of both debt and equity and, depending on the terms of issue, CCUs may rank before or after shares on winding up and may be traded on the open market.

Co-ops may issue debentures or borrow from financial institutions to raise debt capital. Borrowing money means that the co-op incurs liability for interest. On the other hand, selling shares to non-members means that the membership of the co-op is diluted: the existing members have to share control of the co-op (and dividends) with the new members.

Co-op v company? Although both entities have some similarities, co-ops embody different ideals and principles from those of companies. There are four main differences:

- Co-ops aim at benefits to members rather than, as in companies, the provision of a return on members’ capital. As such, co-ops are not entities suitable for speculative investment but are more suitable for long term investment by persons with an interest in the goods or services provided.

23. eg, these principles are reflected in the *Co-operatives Act 1992* (NSW) sec 6.

- Co-ops are bound by the co-op principles, while individual and corporate profit is the rationale behind companies.
- The limitations on voting in co-ops do not encourage the type of investment that drives corporate investment.
- Traditionally, shareholders in companies have no right to participate in the company's business, whereas members of co-ops are required to actively participate in the operations of their co-op or they can be expelled from the membership.

¶9-280 Classification by liability: (1) companies limited by shares. The most common form of registered company is the proprietary (private) or public company limited by shares (Corporations Law sec 9, 112(1)). Such a company has the following features:

- It is incorporated with a share capital, often divided into shares of different classes.
- It may allot and issue shares as the directors think fit.
- Each subscriber is allotted one or more shares on terms that payment of the amount thereof will be made to the company (the amount so paid being the paid-up capital).
- The liability of the members is limited to the amount (if any) unpaid on their shares.
- The shares are personal property of the members and (subject to any constraints in the constitution or rules) are freely transferable.

¶9-290 Classification by liability: (2) companies limited by guarantee. A company limited only by guarantee differs from a company limited by shares in that the liability of the members is to contribute to the company in the event of its winding up, not upon their acquisition of membership (Corporations Law sec 9, 112(1)). In that event, the members agree ("guarantee") to provide to the company such funds, up to a specified limit per member, as are necessary for it to meet any excess of liabilities over assets. It is usual for the amount of the members' guaranteed contribution to be fixed, but it may be determinable by reference to the state of the company's affairs at the time of winding up, provided that the formula for determination is sufficiently certain. In the case of most incorporated clubs (for which the guarantee company is extensively used) the guaranteed amount is usually two or four dollars.

Because the member is not required to contribute until the winding up, a company limited by guarantee only does not have an issued or uncalled capital. There is no statutory provision for the increase or reduction of the amount of the guarantee, either by amendment of the company's constitution or by agreement among the members. This inflexibility may make it difficult for the company to raise loan finance. Further, because the company does not have a share capital, it cannot be incorporated as a proprietary company

(Corporations Law sec 113, and see ¶9-330—¶9-340), and so must comply with the requirements for a public company.

These considerations make the company limited solely by guarantee unsuitable for most trading purposes. However, the guarantee company is a useful device where the primary objective sought is not the establishment of a trading entity but the acquisition or conferring of the status of membership.

¶9-310 Classification by liability: (3) unlimited companies.

The unlimited company differs from companies limited by shares or guarantee in that its members are liable to contribute to the company, to the extent of their resources, to permit it to discharge its liabilities in the event of its winding up (Corporations Law sec 9, 112(1)). Before 1862, all companies had unlimited liability.

An unlimited company must be formed with a share capital, and the law governing the allotment and issue of its shares is similar to that governing limited companies. Any company may reduce its capital without the approval of the court under sec 256B.

Although an unlimited company does not confer the protection of limited liability upon its members, it is nevertheless a separate legal entity, and its members are liable, not to the creditors of the company (who deal with the incorporated entity), but to the company itself. Consequently creditors can only claim on the assets of a member by means of the procedure of winding up the company. On a winding up, the provisions relating to unpaid calls on shares apply if the company has a share capital, but thereafter each member is individually liable to the extent of the debts contracted before the time at which that member ceased to be a member.

Under the Corporations Law, a company incorporated as an unlimited company may convert to a limited company: sec 162. A company incorporated as a limited company may convert to an unlimited company: sec 162.

¶9-320 Classification by liability: (4) no-liability companies.

No-liability companies are a type of company especially developed for the purposes of the Australian mining industry (Corporations Law sec 9, 112(1), 112(2)). They are unique in that the members are not legally liable for calls made by the company either during its lifetime or, through the liquidator, in winding up. The penalty for failure to pay calls is, first, that during the period in which the calls are unpaid the member is not entitled to participate in any dividends and, second, if the calls are not paid within a specified period the shares are forfeited, following which they are offered for sale by public auction (Corporations Law sec 254M-254R). If members do not redeem their interest before sale, by payment of the outstanding amount, they lose their interest in the shares.

There are a number of restrictive provisions in the Corporations Law designed to protect the members of no-liability companies, who are often inexperienced investors and speculators. Principally, a no-liability company

must include in its name the words “No-liability” or its abbreviation “NL” as a warning to persons dealing with such a company.

¶9-330 Classification by membership: public and proprietary companies. Within the framework of four types of company discussed above (¶9-280—¶9-320) there is another classification of companies into—

- (a) proprietary company (¶9-340—¶9-345), and
- (b) public company, which may or may not be listed on the Stock Exchange (¶9-350).

In general terms, the purpose of this distinction is to separate those in which the public has (or is invited to have) a substantial direct interest from those representing the investments of a small number of shareholders, be they natural persons or other corporations. The latter group — proprietary companies — are relieved of many of the obligations and limitations of public companies.

¶9-340 Proprietary companies. A company (other than a no-liability company) may be incorporated as a proprietary company under Corporations Law sec 113 if it has a share capital, and its membership is limited to not more than 50 (counting joint holders as one person and not counting employees).

Advantages. A company which is a proprietary company is relieved of a number of the obligations and requirements that apply to public companies. Some of these are—

- A proprietary company does not have to hold an annual general meeting: Corporations Law sec 250N.
- There need only be one director, a natural person who must ordinarily reside in Australia; a public company must have three directors, all natural persons, two of whom must ordinarily reside in Australia: Corporations Law sec 201A.
- There are fewer restraints upon the appointment or continuance in office of a director: Corporations Law sec 203A–203F.

Disadvantages. As against these benefits, the proprietary company has the obvious disadvantage of restriction on membership and a prohibition against going to the public for money.

¶9-345 Large and small proprietary companies. A proprietary company is either a “large proprietary company” or a “small proprietary company”.

A large proprietary company is one that satisfies (when any controlled entities are taken into account) any two of the following three tests:

- consolidated annual gross operating revenue of at least \$10 million;
- end of financial year consolidated gross assets of at least \$5 million;

- 50 or more full time employees (or their part time equivalent) at the end of the financial year: sec 45A(3).

Any other proprietary company is a “small proprietary company”: sec 45A(2).

The main difference between the two types of company (apart from their size) is that large proprietary companies have to lodge audited financial reports with ASIC each year: sec 292. Small proprietary companies do not even have to prepare annual financial reports.

¶9-350 Public companies. Public companies are those with some ownership by the public, unrestricted by the limitations that apply to proprietary companies (sec 113: ¶9-340): sec 9. They may or may not be listed; in some circumstances it may be appropriate to acquire control of, or establish, a company listed on the official list of the Australian Stock Exchange Ltd (ASX) (see ¶13-400). The benefit of such a move is to gain access to the national capital market, at the price of parting with a proportion of the equity in the company.

The principal requirements for obtaining listing are:

- (1) A certain minimum issued capital and spread of holdings is prescribed.
- (2) Provisions are required to be included in the company’s constitution which are designed to secure the equal treatment of all shareholders in relation to participation in dividends, capital distributions and voting.
- (3) The company’s constitution (¶9-430) must provide for the unrestricted transfer of shares (or debentures, as the case may be: for the distinction see ¶13-480).
- (4) The company’s constitution must provide for a capacity in shareholders to exercise ultimate control over the board of directors.
- (5) Exhaustive provisions in relation to the disclosure of information affecting the value of the interest of investors in quoted securities are imposed.

Advantages. The marketability of a security which has been listed with the stock exchange will normally be far better than that which is not listed. This is not only due to the availability of ready quotations for the listed security but is also due to the investor’s knowledge that the exchange has insisted on compliance with certain requirements before the security was listed. The investor knows also that all material activities and changes pertaining to listed companies must be publicly disclosed under the terms of the listing agreement, as must be all transactions effected on the exchange. Finally, the investor is aware of the strict trading, financial and ethical rules which the exchanges impose on their members who deal in listed securities.

The improved marketability that normally goes with the listing of a security is a major advantage but not the only one. Listing of a security facilitates valuation of that security. It also facilitates the determination of value for such purposes as stock options for executives and subsequent debt

financing. Added to these must be the prestige that usually accompanies a listed security which at times, such as when the security is used as a collateral or when a merger takes place, may mean that a better value is obtained than would be the case with an unlisted security.

Disadvantages. The ASX Listing Rules have more disclosure requirements than those in the Corporations Law (§9-540), such as preparation of a preliminary final statement, additional details for the annual report and additional details for mining exploration companies.

¶9-370 Governing law. The development of Australian law concerning companies combines States' rights and the Commonwealth government's initiative to create one national regulatory scheme to take its place in the international financial markets.

The *Concrete Pipes case*²⁴ authorised the making of Commonwealth legislation regulating the trading practices of the corporations set out in sec 51(xx) of the Constitution, namely, "foreign" corporations, "trading" corporations and "financial" corporations (which are already incorporated) (§1-475). For example, a law stating that "No trading or financial corporation formed within the Commonwealth shall ..." or "Every trading or financial corporation formed, etc, shall ..." is a law validly made under sec 51(xx) unless forbidden under another provision of the Constitution.²⁵

Interpretation and expansion of the corporations power commenced in 1909, and continued to evolve in response to the development of one national Australian economy and one national market instead of six different State markets.

Foreign corporations. Power over foreign corporations is accepted to be a wide grant of Commonwealth power. Foreign corporations include those incorporated outside Australia.

Trading corporations. The expression "trading corporation" extends to all trading corporations formed within the limits of Australia whenever and however formed.

The High Court accepts that a corporation is a trading corporation if trading is a substantial activity of the corporation. For example, the expression "trading corporation" ranges from an incorporated trade association of about 37 members operating on the basis of voluntary members' labour, which provides advice to members, maintains a code of ethics and arranges for an annual trade show,²⁶ to the Hydro-Electric Commission of Tasmania. The fact that the latter could also be characterised as a public utility is immaterial, because its trading purpose and trading activities were held to be substantial

24. (1971) 124 CLR 468; see also §7-220 fn.

25. *Huddart Parker & Co Pty Ltd v Moorehead* (1908) 8 CLR 330, per Griffith CJ at p 348; §7-220.

26. *The Australian Beauty Trade Suppliers Ltd v Conference and Exhibition Organisers Pty Ltd* (1991) 29 FCR 68; (1991) ATPR ¶41-107.

and significant, if not predominant.²⁷ "Trading corporation" does not include the body corporate of a building or a block of home units unless it engages in commerce (activities) beyond the immediate requirements of the proprietors.²⁸

Financial corporations. The test for determining whether a corporation is a financial corporation within sec 51(xx) of the Constitution is the same as that applied to determining whether a corporation is a trading corporation. That is, the courts look to the substantial activities of the corporation. The requisite activities include "activity" in financial dealings. For example, a corporation which receives government funding from which it makes payments as grants, not loans, on a "not for profit" basis is not a financial corporation.²⁹

Corporations already "formed". The High Court in 1990, by a majority of six to one, upheld the constitutional challenge by three States (NSW, SA, WA) to part of the Commonwealth's proposed national scheme for corporate regulation, namely, the incorporation provisions of the *Corporations Act 1989* (Cth).³⁰ (By agreement, most of the other provisions were not tested.) The actual words used in sec 51(xx) of the Constitution (¶1-475), earlier case authority, and the federal Convention debates of the 1890s were held to confirm that Commonwealth legislative power, limited to corporations already "formed", excluded the power to legislate on incorporation of companies. The High Court's rejection of such important parts of the proposed Commonwealth legislation led to redesign in 1990 of some aspects of the existing 1982 State-based co-operative scheme to create the "national" State and Commonwealth scheme.

"National" scheme for companies and securities regulation (1990). Before moves to a national and effective scheme for corporate regulation in the 1970s, State/Territory company law contained in 1961-1962 legislation was fragmented and often led to duplication, overlap, expense and inequality in dealing with corporate matters — for instance, in the fight against "white-collar" and corporate crime (see ¶2-240ff), tax evasion schemes, investor fraud, market manipulation and so on. The Rae Report (1974) (¶13-400), set up to investigate unsavoury aspects of the Poseidon/mining boom of the late 1960s, documented the inadequacies of the then State-based companies legislation and stock exchange self-regulation.

Commonwealth regulation of companies and securities markets was proposed by the Whitlam federal Labor government in 1974 with the *Corporations and Securities Industry Bill 1974* (Cth). The companion *National Companies Bill 1975* (Cth) was to be introduced in Parliament, but it lapsed on the change of government in 1975. The co-operative federalism of the

27. *Commonwealth of Australia v State of Tasmania* (1983) 158 CLR 1; (1983) 57 ALJR 450.

28. *Coastalstyle Pty Ltd v The Proprietors, Surf Regency Building Units Plan 4246* (1992) ATPR (Digest) ¶46-090.

29. *Forbes v Australian Yachting Federation Inc* (1996) 131 FLR 241 (Australian Yachting Federation).

30. *New South Wales v The Commonwealth* (1990) 169 CLR 482; (1990) 8 ACLC 120.

Fraser Liberal-National Party government led to the implementation of the co-operative scheme for companies and securities from 1982. This scheme was based on Commonwealth legislation passed only for the Australian Capital Territory by the Commonwealth under the Territories power of the Constitution (sec 122: ¶1-475) and re-enacted by each State and the Northern Territory.³¹ The resulting body of law was called a Code. The Northern Territory entered the co-operative scheme in 1986.

The operation of the co-operative scheme for companies and securities led to some kind of national uniformity in corporate regulation, but it was criticised by the legal and business communities for its lack of responsibility to one Minister or one government, its lack of national uniformity in administration, for being under-resourced and for its focus on State/Territory regional issues.

In response to growing pressures, the Commonwealth took steps to replace the co-operative scheme by building on the Report of the Senate Standing Committee (1987)³² by introducing national legislation into federal Parliament in May 1988.³³ The *Corporations Act 1989* (Cth), the *Australian Securities and Investments Commission Act 1989* (Cth) and ancillary legislation were passed in 1989. The *Australian Securities and Investments Commission Act* came into operation in 1989.

However, following the failure of the incorporation provisions in the High Court in February 1990, the new national scheme was agreed to at the Ministerial Council meeting at Alice Springs in June 1990. As with the co-operative scheme (1982), it depends on each State and the Northern Territory adopting Australian Capital Territory law passed by the Commonwealth under Constitution sec 122 (¶1-475). The Commonwealth is accepted as having sole responsibility under the Constitution for national markets matters — the securities industry, takeovers, public fundraising and the futures industry — while the States retain some role in traditional company law matters.

The Corporations Law³⁴ is applied in each State/Territory as a law of that jurisdiction, while its administration is under the control of a single, Commonwealth authority (the Australian Securities and Investments

31. The co-operative scheme consisted of the *Companies Act 1981* (Cth) and Codes and related legislation. Compare the co-operative schemes for co-operatives (¶9-270), and consumer credit (¶14-080).

32. eg Report by the All-party Senate Standing Committee on Constitutional and Legal Affairs, *The Role of Parliament in relation to the National Companies Scheme*, AGPS, 1987, Ch 3.

33. The legislation consists of some 2,000 new sections and Schedules contained in

the *Corporations Act 1989* (Cth), *Australian Securities and Investments Commission Act 1989* (Cth) and related legislation.

34. The Corporations Law is actually a "schedule" of over 1,000 sections and three Schedules contained in sec 82 of the *Corporations Act 1989* (Cth). Corporations Law sec 1 states that it is to be cited as the "Corporations Law".

Commission — ASIC). The Corporations Law, although technically State/Territory law, is treated as Commonwealth legislation. It is administered by the Commonwealth and is subject to Commonwealth administrative law remedies (§1-160—§1-165). Offences under the Corporations Law are treated as if they are offences under Commonwealth law. Civil jurisdiction rests in State/Territory courts and the Federal Court. Hence, “[t]he tension at the centre of the legislative structure of the ... scheme lies in its attempt to give a series of State-based statutes an aggregate national character.”³⁵

This “tension” has been tested in major constitutional law cases in 1999-2000 which have found some aspects of the national scheme to be unconstitutional:

- *Wakim’s case* confirmed that Commonwealth legislation that intends to vest State jurisdiction on federal courts is invalid: §1-100.
- *Byrnes v The Queen*³⁶ and *Bond v the Queen*³⁷ held that the Commonwealth DPP (§2-110) cannot appeal against a decision made under State law. A State cannot transfer its functions to an officer of the Commonwealth whose functions are created under Commonwealth law.
- *R v Hughes*³⁸ held that the Commonwealth DPP cannot prosecute an offence under State law.

The uncertainty of the existing national regulation will only be overcome by a change to the Constitution by a referendum (such as a change to sec 51(xx): §1-475) to transfer all State government powers over corporations to the Commonwealth, or more realistically, by a referral or a partial referral by the State governments of their powers over corporations to the Commonwealth to allow one-stop federal legislation over corporations.

¶9-380 Regulatory bodies. Section 1(2) of the *Australian Securities and Investments Commission Act 1989* (Cth) sets out many important purposes of corporate regulation (cf §1-230). Primarily, the purpose of corporate regulation is to promote the performance of the financial system in the interests of commercial certainty, of reducing business costs, and of the efficiency and development of the economy. It also aims to maintain investor confidence by ensuring adequate investor protection. Uniformity of administration Australia-wide is another purpose, as is the processing and storage of national scheme documents and information.

The Ministerial Council. Composed of a representative of the Commonwealth, each of the six States and the Northern Territory, the Ministerial Council has a “consultative” role in relation to legislative policy within the Commonwealth’s national markets jurisdiction and a “deliberative” role in

35. Redmond, P, *Companies and Securities Law — Commentary and Materials*, Sydney, LBC Information Services, 3rd ed, 2000, p 63.

36. [1999] HCA 38; (1999) 73 ALJR 1292.

37. [2000] HCA 13; (2000) 74 ALJR 597.

38. [2000] HCA 22; (2000) 74 ALJR 802.

relation to traditional company law matters. Chaired by the relevant Commonwealth Minister, the voting arrangements recognise the primary responsibility of the Commonwealth (four votes) compared to the States/Northern Territory (one vote each). The Commonwealth only requires two votes from the States/NT to carry any proposal. Political responsibility rests with the relevant Commonwealth Minister.

The Australian Securities and Investments Commission. ASIC — a Commonwealth statutory authority — is Australia's corporate watchdog with offices in all capitals,³⁹ and with "Business Centres" and representatives in many regional centres:

- (1) It maintains a publicly accessible national corporate database, with details of companies from setting up to deregistration (ASCOT), and a document imaging facility (DOCIMAGE).
- (2) As regulator of companies, and securities and futures markets, ASIC, in the interests of an economically efficient and fully informed market, and of investor protection, supervises the issue of securities, secondary trading, takeovers and continuing disclosure by companies.

ASIC's policing powers (investigation, inspection, examination) are important, but its hearings power is limited to hearings in relation to these. The power to make declarations of unacceptable conduct or unacceptable acquisition in respect of takeovers is vested in the Corporations and Securities Panel. ASIC can exempt or modify compliance with sections of the Corporations Law. This was illustrated during the Commonwealth Bank "privatisation" in 1991, when the Commission modified the Law to facilitate the bank's publicising the floating of its shares.

ASIC replaced the former ASC (Australian Securities Commission) on 1 July 1998 to include, in addition to securities and futures contracts (derivatives), consumer protection in all financial products such as managed investments, superannuation, life insurance and general insurance (§17-310; §17-590) and deposit taking by banks (§16-010), building societies, credit unions and friendly societies (§9-270) (but not credit).

The former ASC had replaced the National Companies and Securities Commission (NCSC: 1980-1990). As the administrator of the co-operative scheme for companies and securities (1982: §9-370), the NCSC operated nationwide under federal and State/Territory law, and at State/Territory level it operated through the former State/Territory Corporate Affairs Commissions. As the first national regulator, the NCSC achieved some major successes and it laid the foundations for the federal ASC.¹

39. See further: www.asic.gov.au.

1. eg Bosch, H, *The Workings of a Watchdog*, Melbourne, William Heinemann, 1990.

Corporations and Securities Panel. The Panel took over the former NCSC's function of ruling on applications for unacceptable acquisition or unacceptable conduct declarations. The Panel has a wide range of powers (such as those set out in sec 657A to protect those affected, such as restraining orders and injunctions. The Panel, not the courts or the AAT (¶1-160), is the place where takeover disputes are resolved until the end of the bid period. This "separation of powers" gives ASIC the power of investigation and prosecution, but not the power to judge.

Accounting standards. The Financial Reporting Council oversees the setting of accounting standards by the Australian Accounting Standards Board (AASB) (ASIC Act 1989 (Cth) Part 12). Accounting standards first acquired the force of law in 1983 in the predecessor of Corporations Law sec 296.

Companies Auditors and Liquidators Disciplinary Board. This board consolidates previous State/Territory Boards into a single Commonwealth controlling body, and allows the accounting profession to play a role in its own self-regulation.

Companies and Securities Advisory Committee. This committee and its sub-committees provide the relevant Commonwealth Minister with policy advice on law reform issues. Many reports prepared by CASAC staff have led to changes in companies and securities law. Some CASAC publications are available on the ASIC website at www.asic.gov.au.

¶9-390 Establishment. It can take as little as a few minutes to set up a company via the transfer of shares from a ready-incorporated "shelf" company; the only time taken is in transferring the shares. To set up a company from the beginning takes a little more effort.

The corporate form which is of principal use in modern business is the proprietary company limited by shares and incorporated by registration under the companies legislation (¶9-340—¶9-345).

The object of the incorporation procedure (¶9-410ff) is to ensure that the incorporation of a company is a relatively simple process, while at the same time providing a public disclosure of the company's limitations (if any), capital, members and officers, and registered office.

¶9-400 The situation before incorporation. Before incorporation there is no company, only the intending members and the promoters (who may or may not become members). The promoters are those who undertake to form the company and to set it going and who undertake the necessary steps to accomplish that purpose.² The law provides the company and its members with a measure of protection against any exploitation by the promoters of the company during its helpless gestation by directing that the promoters shall not derive any secret profit at its expense.³ In particular,

2. *Twycross v Grant* (1877) 46 LJCP 636.

3. *Tracy v Mandalay Pty Ltd* (1953) 88 CLR 215.

although promoters may sell their property to the new company, they are under a fiduciary duty to disclose to the company that they are doing so (§9-770), and under a duty to place the company in a proper position to decide whether or not to accept the offer, by appointing an independent board of directors to whom the whole position is fully disclosed.

Pre-registration contracts. In the period before the registration of the company, someone (usually the promoters) may need to enter into contracts on behalf of the company — for example, for the hire of premises. Formerly, the common law provided that such a contract could not confer rights or impose liabilities on the company. Nor could the company ratify the contract after incorporation.⁴ Corporations Law sec 131-133 have overcome that common law prohibition and allow ratification of pre-registration contracts, subject to the conditions discussed below:

- The company may, if it wishes, ratify the contract within a reasonable time after incorporation: sec 131(1).
- If the company is not formed or fails to ratify within a reasonable time, the promoter is liable to pay damages equivalent to the damages which the other party could have recovered if the company had been formed and had ratified the contract but had then refused or failed to perform its obligations: sec 131(2). In any such proceedings against the promoter, the court may order that the company restore to the promoter any benefit received under the contract or that the company pay the whole or part of the damages: sec 131(3).
- The promoter does not cease to be at risk just because the company ratifies. In proceedings for damages against a company which has ratified the contract but has failed to perform it, the promoter may be ordered to pay the whole or part of the damages: sec 131(2).
- The promoter may escape liability if the other party has in writing consented to the exemption from liability: sec 132.

§9-410 Incorporating a company. When the matters referred to in §9-010 have been attended to, the steps for incorporating the company may be commenced. Briefly, these are the procedures:

- (1) Select a name (§9-420).
- (2) Draw up a constitution or rules (or adopt the replaceable rules contained in the Corporations Law) (§9-430).
- (3) Sign a consent to become a member of the company.
- (4) Obtain the consent of the proposed directors.
- (5) Complete and lodge the application form (with details of name, address,

4. See *Kelner v Baxter* (1866) LR 2 CP 174; [1861-73] All ER Rep Ext 2009; and *Black v Smallwood* (1966) 117 CLR 52; (1966)

39 ALJR 405. See discussion at §11-090, §11-290.

share capital, etc) with the Australian Securities and Investments Commission.

- (6) After the certificate of registration (sec 118) is received from the Commission, the subscribers should appoint the directors (if not already done) and commence operations.
- (7) Notify details of shares and officeholders.

¶9-420 Name and registration number. The Corporations Law requires every company to have a company name. Those setting up a company must first propose and reserve a name with ASIC. A name will be available if it does not clash with an existing company name, or is not included in the national business names register (¶12-020), or has not been declared by regulation to be unacceptable (Corporations Law sec 147, 601DC).

— *Case example* —

“Virgin Mary’s”. The ASIC’s decision to register “Virgin Mary’s Pty Ltd” as a company name for a bar and night club was set aside as unacceptable on the basis that it might cause offence to members of the Christian and Islamic faiths.

— *Little v Australian Securities Commission*⁵ —

ASIC issues a new company with a unique nine digit Australian Company Number (ACN). Of special value for “shelf companies” is the ability to use the ACN as the company name, such as “Australian Company Number 000 000 000 Pty Ltd”.

From 1999, ASIC allows certain symbols in company names such as # (hash) and \$ (dollar). For example, “@Work Solutions Pty Ltd” would not be considered identical to “At Work Solutions Pty Ltd”.

With the introduction of the GST in 2000, all Australian businesses should have an Australian Business Number (ABN) — or face tax withheld of 48.5% on payments if they do not. ABNs are available for public search on the Australian Business Register Online at www.abr.business.gov.au. If a company carries on a business under a name which is different from its company name, it must register the business name with the relevant State or Territory authority.

A company’s name must appear on its cheques, published documents, and documents lodged with ASIC: sec 153 (¶9-460).

¶9-430 The company’s constitution. A company may choose to be governed by a constitution, or by the “replaceable rules” as explained in Corporations Law sec 135, or by a combination of both.

There are 41 “replaceable rules” set out in Corporations Law sec 141, dealing with directors, directors’ meetings, meetings of members, the company secretary, inspection of books, shares and the transfer of shares:

5. (1996) 14 ACLC 1,730.

- certain replaceable rules are mandatory for public companies,⁶ and
- single director/single shareholder companies are not bound by the replaceable rules but are governed by particular sections of the Corporations Law (such as sec 198E).

The rules on internal management⁷ are contained in Part 2B.4 of the Law.

The requirement for a company to have a memorandum of association and articles of association was abolished in 1998, although companies with an existing memorandum and articles could retain them as the company's constitution unless the company decided otherwise.

¶9-440 Procedure after incorporation. Following the incorporation of the company, the first meeting of directors should then be held, at which various matters should be attended to in order to establish the company's operations satisfactorily.

The more common matters requiring early attention are:

- opening a bank account;
- appointing a public officer, for tax purposes, and a secretary;
- obtaining registration for the purposes of pay-roll tax, group tax, goods and services tax and factory or shop premises as necessary;
- obtaining and opening the appropriate books and records of the company;
- appointing an auditor where required (¶9-550). All public companies must appoint an auditor within one month of incorporation (sec 327);
- arranging appropriate insurances (see Chapter 17).

¶9-450 Continuity of existence. On incorporation a company acquires, as well as legal personality, the attribute of "perpetual succession". Unlike a natural person, it does not (or need not) have a limited life span, nor is the company liable to become incapable by reason of mental or physical illness. The operations of the company may be considerably disrupted by the incapacities of its human members and officers, for example if they should all die, but the company's existence, and its rights and obligations, continue undisturbed.

The effect of Corporations Law sec 119 means that the company, once incorporated, "comes into existence as a body corporate" with perpetual existence. The perpetual existence of a company is not affected by such things as the death of a member, the death of a director or even the insanity of a member or director. The story goes that during World War II all the members

6. At this stage, the only mandatory rule for a public company is in sec 249X ("Who can appoint a proxy").

7. These were previously contained in Table A, which was repealed in the 1998 amendments.

of an English private company were killed by a bomb while in general meeting, but the company survived. Death or incapacity of members will only affect the company where there are too few members to make a quorum for a valid meeting under the companies legislation.

The main business benefit of a company's perpetual succession lies in its continuity through changes of ownership. Where the head of a family and director of the family company dies, the company continues following transfer of shares to the spouse, children or anyone else. In other words, the company can hold property without the constant problem of transmitting it from one generation to the next.

Likewise, where the corporate business is sold, no problems can arise as to whether contracts of the former business are to be performed or not because to the outside world the business remains the same. All that has happened is the sale of shares in the company. The same company remains responsible for, and retains the benefits of, the same contracts.

¶9-460 Limitation of liability. The incorporation of a company as a separate entity has the result that the debts incurred by the company are its debts, and not those of its members (as distinct from a partnership where the debts incurred by the partnership are also jointly and severally the debts of the partners: see ¶10-250). In the absence of any other provision, it would follow that the members would not be liable at all for the debts of the company, and that is the case with municipal and ecclesiastical corporations and many statutory and chartered corporations.

However, members of companies registered under the companies legislation do face different kinds and degrees of liability (set out more fully in ¶9-280—¶9-320). In the case of companies limited by shares, the liability of the members is confined to the amount outstanding in respect of the shares allotted to them; in the case of companies limited by guarantee, the liability of the members is to contribute the amount of their guarantee or such proportion of it as may be required in the liquidation of the company. Still, even in the case of an unlimited company, it is not the members who are primarily liable to the creditors, but the company; in a liquidation, the members are obliged to contribute to the company until it is able to discharge its liabilities to its creditors.

There was much opposition to the provision of limited liability when the company structure enjoyed its nineteenth century debut; ultimately, legal protection developed, and following the decision in *Salomon v Salomon & Co Ltd* (below) the law recognises that a “one-person” enterprise may obtain the benefit of the protection from liabilities to creditors of the enterprise afforded by a limited liability company.

— *Case example* —

The conversion of A Salomon & Co, leather merchant and wholesale boot manufacturer (a firm), into A Salomon & Co Ltd (a limited company) is the foundation of modern company law. Salomon's conversion of his proprietorship in the firm into issued debentures in the company, secured by

way of a floating charge over the assets of the company (¶13-480) ranked his claim to repayment in the ultimate winding up in front of the claims of trade creditors who did not have a security ranking ahead of Salomon's debentures. The creditors unsuccessfully argued that the company was a mere agent of Salomon, and/or that it was a fraud on the then *Companies Act* (which then required seven shareholders whereas there was in reality only one) and/or that the business was sold in excess of its real value.

*Salomon v Salomon & Co Ltd*⁸ —

Limitation of liability is a major advantage in commercial terms. It permits the establishment of a business without exposing to the risks associated with it the private assets of the controller and, indirectly, beneficial owner of the enterprise. In consequence, the limited liability company has been the main device used by entrepreneurs in the common law legal system, and similar devices have been established in civil law jurisdictions. However, it should not be assumed that the controllers of a limited liability company may proceed to incur liabilities to creditors without regard to the company's ability to repay them. The courts have in some circumstances permitted the "corporate veil" to be lifted.

The Corporations Law also introduces some exceptions to the principle of limited liability such as:

- Section 153. Under sec 153 the company's correct name (including "Limited" or "Ltd") and registration number must appear legibly on public documents (as defined in sec 88A) and negotiable instruments: ¶9-420. Default renders the company and the officer responsible guilty of an offence.
- Section 197 imposes joint and several personal liability on directors of a corporate trustee in certain circumstances: ¶9-900.
- Section 588G places on a director a duty to prevent insolvent trading by the company (¶9-480).⁹ Failure to discharge that duty may render a director personally liable for insolvent trading debts incurred by the company.

— *Case example* —

A director of the failed National Safety Council was held to be personally liable for Council debts of \$97m. The court held that, as a director signing the accounts (¶9-540) for the annual general meeting, checking what he signed would in all probability have led to the exposure of the fraud of the former chief executive officer, John Friedrich, and the curtailing of further losses.

*Commonwealth Bank of Australia v Friedrich*¹⁰ —

8. [1897] AC 22; [1895-99] All ER Rep 33.

9. Incorrect representations about the solvency of a company may be litigated as "misleading or deceptive conduct" under sec 52 of the *Trade Practices Act*

1974 (Cth); eg *New England Agricultural Traders Pty Ltd v Adams* (1994) ATPR ¶41-361 (¶7-280).

10. (1991) 9 ACLC 946, noted, eg, (1991) 65 ALJ 738; (1991) 21 QLSJ 347.

Other laws also lift the veil of incorporation. For example, income tax law requires that every company (legal person) carrying on a business or deriving income from property must appoint a flesh and blood resident public officer (natural person) who is answerable for the doing of all things required to be done by the company under the *Income Tax Assessment Act 1936* (Cth), and who, if it is in default, is liable to the same penalties. However, the public officer is not personally liable for the payment of tax due by the company.

The Corporations Law recognises the commercial reality of the association among holding and subsidiary companies by requiring the preparation of consolidated financial statements. However, some members of the legal profession have questioned whether the law goes far enough in recognising that a group of companies is often just a single commercial enterprise.¹¹

¶9-470 Control. A company, being a paper structure, must act through one of its duly constituted organs — the general meeting or the board of directors, or their delegates or agents.

Role of directors. It is usual for the control of the company's business to be placed in the hands of the board of directors, although the company's constitution may otherwise provide, for example by placing all control in the hands of a governing director or "president" (who is none the less a director). The main duty of directors is to exercise their powers for proper purposes. As they owe a fiduciary duty to the company, they must discharge their duties with honesty, skill and diligence. Chapter 2D of the Corporations Law confirms, re-states, partly codifies and partly extends the recognised common law duties of directors (¶9-480).¹²

A consequence is that the intention of the company is to be determined by the intention of the directors, and determination of corporate knowledge in a large corporation will depend on the accepted lines of communication. Even if the directors act informally, their actions — in the context of their position within the company, the question under consideration and any other relevant circumstances — may be taken as an indication of the company's "intention".

Role of members. Section 198A of the Corporations Law (a replaceable rule) vests the management of the company's affairs in the directors subject to any regulations made by the general meeting. However, it is now clear that the members in general meeting cannot exercise this power to interfere with the course of action resolved upon by the directors, for the directors are not in any relationship of agency with the members, nor are their powers merely delegated, and they are not bound to conform to the wishes of the members

11. eg *Qintex Australia Finance Ltd v Schroders Australia Ltd* (1991) 9 ACLC 109 at p 111 per Rogers CJ (Comm Div), noted (1991) 65 ALJ 352.

12. See, eg, Parsons, RW, *The director's duty of good faith* (1967) 5 MULR 395;

Sealy, L, *Directors' "wider" responsibilities — problems conceptual, practical and procedural* (1987) 13 Mon LR 164.

expressed in general meeting. The ultimate sanction of the members is withdrawal of a director's powers by removing the director from office.

Statutory derivative action. Part 2F.1A (sec 236-242), in force in 2000, provides that a member or officer of a company can bring or intervene in proceedings on behalf of the company and in the name of the company. This Part abolished the "rule in *Foss v Harbottle*"¹³ which had provided that if a wrong had been done to the company, only the company was the "proper plaintiff" able to commence proceedings. The exceptions to *Foss v Harbottle* which had developed to allow personal action against management are no longer relevant.

Other remedies in cases of maladministration. In addition to Part 2F.1A providing for statutory derivative actions, the Corporations Law sets out a number of provisions giving remedies to company members and/or ASIC where there has been company maladministration:

- (1) remedy in the case of oppression or injustice: Part 2F.1, sec 232-235;
- (2) application for a winding up order: sec 461 (¶9-610);
- (3) complaints about the conduct of a liquidator (sec 536);
- (4) examination of persons connected with the company (sec 596A-597);
- (5) application where there is "fraud, negligence, default, breach of trust or breach of duty in relation to a corporation": sec 598;
- (6) application to enforce business or listing rules of a securities exchange: sec 777;
- (7) application for an injunction to restrain a breach of the Corporations Law: sec 1324.

Persons having dealings with companies: sec 128-129. A person who deals in good faith with persons who can reasonably be supposed to have the customary authority of the company will be protected against later claims by the company that those persons purporting to act for it in fact lacked that authority: see sec 128-130.

In particular, a person so dealing in good faith is authorised under sec 129 to make the following assumptions:

"129(1) A person may assume that the company's constitution (if any), and any provisions of this Law that apply to the company as replaceable rules, have been complied with.

129(2) A person may assume that anyone who appears, from information provided by the company that is available to the public from ASIC, to be a director or a company secretary of the company:

- (a) has been duly appointed; and
- (b) has authority to exercise the powers and perform the duties customarily exercised or performed by a director or company secretary of a similar company.

13. (1843) 2 Hare 461; 67 ER 189.

129(3) A person may assume that anyone who is held out by the company to be an officer or agent of the company:

- (a) has been duly appointed; and
- (b) has authority to exercise the powers and perform the duties customarily exercised or performed by that kind of officer or agent of a similar company.

129(4) A person may assume that the officers and agents of the company properly perform their duties to the company.

129(5) A person may assume that a document has been duly executed by the company if the document appears to have been signed in accordance with subsection 127(1). For the purposes of making the assumption, a person may also assume that anyone who signs the document and states next to their signature that they are the sole director and sole company secretary of the company occupies both offices.

129(6) A person may assume that a document has been duly executed by the company if:

- (a) the company's common seal appears to have been fixed to the document in accordance with subsection 127(2); and
- (b) the fixing of the common seal appears to have been witnessed in accordance with that subsection.

For the purposes of making the assumption, a person may also assume that anyone who witnesses the fixing of the common seal and states next to their signature that they are the sole director and sole company director of the company occupies both offices.

129(7) A person may assume that an officer or agent of the company who has authority to issue a document or a certified copy of a document on its behalf also has authority to warrant that the document is genuine or is a true copy.

129(8) Without limiting the generality of this section, the assumptions that may be made under this section apply for the purposes of this section."

In particular, sec 129(1) represents a clarification and partial codification of the "rule in *Turquand's case*"¹⁴ to the effect that an outsider dealing with a company is entitled to assume that the internal rules of the company have been duly complied with. Under that common law rule, outsiders were deemed to have had notice of the company's public documents (§9-490ff) so that any act which was clearly contrary to those documents would not bind the company unless it was subsequently ratified by the company. Provided that everything appeared to be regular so far as could be checked from the public documents, an outsider dealing with a company was entitled to assume that all internal regulations of the company had been complied with, unless the outsider had knowledge to the contrary or there were circumstances raising inquiry. Accordingly, an outsider dealing with a company through an officer or agent who was, or who was held out by the company to be, a particular type of officer or agent, and who purported to exercise a power which that type of officer or agent would usually have had, was entitled to

14. *Royal British Bank v Turquand* (1856) 6 E & B 327; 119 ER 886.

hold the company liable for the acts of the officer or agent, even though that person had not been so appointed or was in fact exceeding actual authority. Sections 129(2), 129(3) and 129(4) in part codify existing agency law (§11-110—§11-130).¹⁵

No “constructive notice” of documents. A person is no longer held to have constructive notice of documents just because they have been lodged with the Australian Securities and Investments Commission.¹⁶

¶9-480 Directors’ duties to their company. Ownership and control of large public companies are usually separate, and directors (and management) do not usually own much if any of their company. Because they are often managing other people’s money, the law places strict duties on directors to account and to be accountable.

The basic duty owed by directors to their company — to exercise their powers for proper purposes and not to act oppressively¹⁷ — derives from statutory and common law rules:

Statutory duties of directors: sec 180-184. The fiduciary duties of directors at common law are supplemented by statutory duties under the Corporations Law. Under the statutory duties in sec 180-184, directors must:

- “exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise”: sec 180(1). The business judgment test in sec 180(2), which gives directors a “safe harbour” from personal liability for decisions regarding the corporation, provides that directors meet the requirements of sec 180(1) if they:
 - “(a) make the judgment in good faith and for a proper purpose; and
 - (b) do not have a material personal interest in the subject matter of the judgment; and
 - (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
 - (d) rationally believe that the judgment is in the best interests of the corporation.”

These defences do not apply to business judgments regarding matters outside sec 180(1) such as insolvent trading, or mis-statements in a prospectus or takeover.

- exercise their powers and discharge their duties “in good faith in the

15. See in particular *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480 at p 506; [1964] 1 All ER 630 at p 646 (§11-130).

16. With the exception of registrable charges (§13-048, §13-480, §13-540) which are still covered by the doctrine of constructive notice.

17. *Gambotto v WCP Ltd* (1995) 69 ALJR 266; (1995) 13 ACLC 342. This case rejected as inappropriate the “bona fide and for the benefit of the company as a whole” test of *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656 at p 671.

best interests of the corporation [ie the members as a whole] ... and for a proper purpose”: sec 181.

- not improperly use their position to “gain an advantage for themselves or someone else ... or cause detriment to the corporation”: sec 182.
- not improperly use corporate information “to gain an advantage for themselves or someone else ... or ... cause detriment to the corporation”: sec 183.

If these duties are breached, ASIC, the DPP (¶2-110) or the company can apply to the court under Part 9.4B for a declaration of contravention (sec 1317E), a “civil penalty” under Part 9.4B (sec 1317G ff), involving a fine of up to \$200,000 and/or a compensation order (sec 1317H). Breach of civil penalty provisions may give rise to criminal offences under the Corporations Law.

Section 184 establishes a criminal offence with a penalty of \$30,000 and/or five years jail if a director fails to exercise their powers in good faith in the best interests of the company.

Related party transactions. Chapter 2E (sec 207-227) prohibits a public company from giving a financial benefit to directors and related parties of directors unless disclosed to and approved by a general meeting. Chapter 2E builds on the fiduciary duties of directors at common law, and is designed to protect the public company’s resources (especially those available to protect creditors) and the interests of its members.

Other statutory duties of directors. In addition to the overriding statutory duties of directors set out in sec 180-184, various other sections of the Corporations Law impose statutory duties usually supported with a sanction (penalty by way of a fine and/or imprisonment) such as:

- the duty to ensure that the prospectus complies with the Corporations Law sec 711;
- the general duty of disclosure (sec 205C);
- the duty to ensure that proper financial records are kept (sec 286);
- the duty to prevent the company trading once there is reasonable cause to suspect that the company cannot pay its debts in full (sec 588G) (¶9-460);
- the duty to ensure that dividends are paid out of profits (sec 254T);
- liability for unremitted taxation, under the *Insolvency (Tax Priorities) Legislation Amendment Act 1993* (Cth).

Directors’ duties at common law

(1) **Directors’ duties of good faith and loyalty.** As fiduciaries (¶9-770), directors owe a duty of economic loyalty to the company. Directors must not exercise their powers for any private advantage or for any private purpose. They must act honestly in what they believe to be the best interests of the company. In short, directors are under a:

- duty to act in good faith (“bona fide”) in the interests of the company as a whole.
- duty to exercise their powers for their proper purpose. Powers that can be misused include the power to issue shares to maintain control, the use of company funds to assist the re-election of a director, the refusal to register a transfer of shares, and the power of management. Directors must exercise their powers for the benefit of the company and not for any collateral or improper purpose.
- duty to retain their discretion, or not to limit the exercise of their future discretion.¹⁸ For example, an agreement by directors to vote in a particular way at future board meetings would limit the exercise of their discretion.
- duty to avoid actual and potential conflicts of interest and duty — between their personal interests and their duty to the company — so as to prevent them from making a profit out of their position.¹⁹

“A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such an agent has duties to discharge of a fiduciary character towards his principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect. So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.”

Hence a director must not take private advantage of an opportunity which is available to the company, because it is not the director’s opportunity to take up.

(2) *Directors’ duties of care and skill at common law.* At common law, directors may be liable in tort for breach of the duty of care:

- (i) *skill*: A director “has a duty greater than that of simply representing a particular field of experience. That duty involves becoming familiar with the business of the company and how it is run and ensuring that the board has available means to audit the management of the company so that it can satisfy itself that the company is being properly run.”²⁰
- (ii) *diligence*: The responsibilities of directors “require that they take reasonable steps to place themselves in a position to guide and monitor the management of the company.”²¹

18. It is sometimes said that directors must not “fetter” their discretion.

19. *Aberdeen Railway Company v Blaikie Brothers* (1854) 23 LT (OS) 315 at p 316.

20. *Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (the AWA

case) (1995) 13 ACLC 614 at p 662; Cassidy, J, *Has the “sleeping” director finally been laid to rest?* (1997) 25 ABLR 102.

21. The AWA case (above) at p 662.

- (iii) *reliance on others*: “The board may be assisted by sub-committees consisting of its members, including non-executive directors.”²²

The “business judgment” rule. Directors “must be allowed to make business judgments and business decisions in a spirit of enterprise untrammelled by the concerns of a conservative investment trustee ... Great risks may be taken in the hope of commensurate rewards”. If the venture fails, the director is not automatically liable, and is to be judged under the *Donoghue v Stevenson* test of negligence (¶4-080).²³

Directors’ duties to creditors. Company law recognises that a company is a separate legal entity which is separate from its directors and shareholders. Exceptions to this principal include:

- (1) *Directors’ duty to prevent insolvent trading.* The Corporations Law aims to protect creditors from being presented with an empty shell by lifting the “corporate veil” to put a duty on directors to prevent insolvent trading and to hold them personally liable for company debts incurred while insolvent (sec 588G: ¶9-460).
- (2) *Order to compensate.* Under sec 598(2), directors and others may be liable to compensate a company for loss as a result of their fraud, negligence, default, breach of trust or breach of duty.²⁴

If a company is insolvent, the effect of these sections is to increase the assets available for distribution to its creditors.

Disclosure of interests. If there is a potential conflict of interest, directors must disclose their interest in the proposed transactions and have their proposed action ratified by the company in general meeting.

¶9-490 Formalities: (1) adherence to constitution or replaceable rules. A company may have a constitution. Alternatively, if a company does not adopt a constitution then its internal management is governed by the replaceable rules. (See ¶9-430.) Sections 134 and 140 of the Corporations Law outline certain formalities for the constitution and replaceable rules of a company.

Before 1984, companies legislation required a company to have a memorandum which stated the company’s objects. As a result, a company’s memorandum had traditionally consisted of numerous clauses containing the objects of the company enumerated in great detail, ranging from the prime reason for which the company is established (“(a) To carry on the business of shoe manufacturers”) and continuing through the alphabet to (z) or even sometimes (zz). In addition to listing the company’s objects or aims, the objects clause often included the company’s powers (the power to borrow

22. *Loc cit.*

23. *Ibid*, pp 662-663, noted Baxt, R, *Do we now need a business judgment rule for company directors?* (1995) 69 ALJ 571.

24. eg Mescher, B, *Personal liability of company directors for company debts* (1996) 70 ALJ 837.

on first mortgage, etc), and the powers contained in the former Schedule 2 of the now repealed *Companies Act 1981* (Cth) and Codes (unless excluded or modified). This practice of stating every possible activity in which the company might get involved arose because of the doctrine of *ultra vires* (see also ¶5-570).

The doctrine was based on the principle that a company which is incorporated under statute cannot do anything beyond the powers expressly or impliedly conferred by its memorandum of association as all activity in excess will be void even if agreed to by all the members. Failure to adhere to this simple rule used to mean that a contract made outside a company's objects could not be enforced by the company or could not be enforced against the company.

The doctrine of *ultra vires* (as it affected persons dealing with a company) was abolished in 1984 and with it went the need to set out numerous objects clauses. Section 124 of the Corporations Law now provides that "a company has the legal capacity and powers of an individual".

Persons dealing with a company cannot now be met with the defence of *ultra vires* and an act of a company is not invalid only because it contravenes the constitution, even if specifically prohibited by the company (sec 125(1)).

¶9-500 Formalities: (2) maintenance of registered office.

Every company must have a registered office (sec 142). It need not be the company's principal place of business, but it must be on public record as a place at which the company can be contacted. A document or notice (such as a notice of demand) is taken to be duly served by leaving it at or posting it to the registered office (sec 109X). In practice the office is often that of the company's accountant or solicitor.

¶9-510 Formalities: (3) reporting requirements. The legislation requires a company to keep such financial records as correctly record and explain the transactions and financial position of the company. They must disclose a true and fair view of the company's position, and must be up to the standard ordinarily used in that class of business.

The Corporations Law imposes direct responsibility on directors for ensuring that the financial reporting provisions of the Law are complied with and that the company's financial statements (where required) are made out in accordance with applicable approved accounting standards (¶9-380). Additionally, the Law requires a directors' report to be submitted to a public company or large proprietary company with the annual profit and loss account, statement of cash flows and balance sheet, which reports on specific aspects of the financial statements, such as the provisions for bad and doubtful debts. The directors must also state whether, in their opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they fall due (sec 346). The aim of these statements and reports is to give a true and fair view of the state of the company's affairs as at the end of the financial year (sec 297), including a true and fair view of the

company's profit or loss for the relevant year. In their report, the directors must comment on a number of items which may reflect on the accuracy of the valuation shown for the company's assets, reserves and other items (sec 299-300A). Public and large proprietary companies must send copies of all financial reports and associated statements and reports to all persons entitled to receive notice of general meetings, not less than 21 days before each annual general meeting (public companies) or no more than four months after the end of the financial year (large proprietaries) (sec 315).

¶9-520 Formalities: (4) maintenance of registers. The Corporations Law abounds with registers to be kept which constitute documents additional to the financial records themselves. It is the responsibility of the directors to ensure that the registers are kept and to supply the information necessary for inclusion in certain of the registers. The necessary records include:

- Register of members.
- Register of debenture holders.
- Register of charges.
- Register of option holders.
- Register of substantial shareholders.

One of the most important reasons for keeping "books" (defined in the Corporations Law to include registers, records of information, financial reports, however compiled, recorded or stored (¶9-540) and any related document) is to provide information to the market, the regulators, and to creditors and members. Sections 247A and 247B confirm the right of a member of a company acting in good faith to apply for a court order if necessary for the appointment of a registered company auditor or a legal practitioner to inspect and to make copies of the company's books if for a "proper purpose". The section has been used successfully by shareholders on several occasions. In a number of those cases the shareholder also happened to be in the course of, or preparing, a takeover bid for the company. On each occasion on which inspection was ordered, the court found that the shareholder was seeking inspection for the purpose of protecting its legitimate interests as a shareholder, rather than solely for the purpose of aiding its takeover bid; an application solely for the purpose of aiding a takeover bid, said the courts, would not be allowed.

¶9-540 Formalities: (5) financial statements. Public and large proprietary companies are required to make certain disclosures in their financial statements to company management, to creditors and to the market generally as a result of:

- (a) Chapter 2M of the Corporations Law (entitled "Financial reports and audit") requires preparation of a profit and loss account, a statement of cash flows, a balance sheet, a directors' report and a directors' declaration on whether the financial reports give a true and fair view.

Section 285 sets out the following summary of financial reporting requirements under the Corporations Law:

Annual financial reporting

<i>Steps</i>	<i>Sections</i>	<i>Comments</i>
1. Prepare financial report	295	The financial report includes: <ul style="list-style-type: none"> • financial statements • disclosures and notes • directors' declaration.
2. Prepare directors' report	298	The report has both a general component (sec 299) and a specific component (sec 300).
3. Have the financial report audited and obtain auditor's report	301, 307, 308	A small proprietary company preparing a financial report in response to a shareholder direction under sec 293 only has to have an audit if the direction asks for it. Under sec 312, officers must assist the auditor in the conduct of the audit. ASIC may use its exemption powers under sec 340 and 341 to relieve large proprietary companies from the audit requirements in appropriate cases (sec 342(2) and (3)).
4. Send the financial report, directors' report and auditor's report to members	314	A concise financial report may be sent to members instead of the full financial statements (sec 314(1)-(2)). For deadline see sec 315(1)-(4).
5. Lodge the financial report, directors' report and auditor's report with ASIC	319	For deadline see sec 319(3). Companies that have the benefit of the grandfathering in sec 319(4) do not have to lodge.
6. [public companies only] Lay financial report, directors' report and auditor's report before AGM	317	For the AGM deadline see sec 250N.

- (b) the Australian Stock Exchange Ltd (ASX) through its Listing Rules for listed public companies which require amongst other things detailed half-yearly reports to the Exchange (§9-350).

- (c) the requirements of the joint accounting bodies, which require compliance with accounting standards to reduce diversity in accounting. Although not legally enforceable (at least not until adopted by the Australian Accounting Standards Board: ¶9-380), accounting standards are given effect to by various methods such as qualifications in auditors' reports and possible disciplinary action by the joint accounting bodies.
- (d) international influences through such bodies as the International Accounting Standards Committee (IASC) which are especially relevant in the case of multinational companies and Australian companies engaged in international trade.

Complying with such disclosure requirements is a time-consuming business and finance theory in particular indicates that disclosure should not be legislated for, as analysis of disclosure requirements shows they have little influence on the market. Instead, finance theoreticians argue, disclosure should be left to the market.

¶9-550 Formalities: (6) audit requirements. Part 2M.3 Div 3 of Chapter 2M of the Corporations Law sets out the provisions on audit and auditors' reports.

The Corporations Law provides that an auditor of a company is to report to the members of the company on the financial statements required to be prepared by the company. The auditor's report is required to state whether the financial statements are drawn up so as to give a true and fair view of the matters required by the Corporations Law: ie whether all the information and explanations that are required have been obtained; whether proper financial records and registers have been kept; and whether returns from branch offices of the company are adequate (sec 308). Further, auditors are specifically required to report any suspected breaches of the Corporations Law to ASIC (sec 311).

The appointment of the auditor as a "watchdog" over company affairs²⁵ is important for investors. Certainly the auditor's duty includes warning the members of the client company of areas of weakness in the company's internal control, and the detection of error and fraud. The High Court has given judicial approval to the following passage from Irish, *Practical Auditing*:

"An audit may be said to be a skilled examination of such books, accounts and vouchers as will enable the Auditor to verify the Balance Sheet. The main objects of any audit are:

- (a) To certify to the correctness of the financial position as shown in the Balance Sheet, and the accompanying revenue statements.
- (b) The detection of errors.

25. *In re Kingston Cotton Mill Co (No 2)* [1896] 2 Ch 279: the auditor "is a watchdog, but not a bloodhound"; see

discussion in *Pacific Acceptance Corporation Ltd v Forsyth* (1970) 92 WN (NSW) 29 (noted at ¶4-120).

(c) The detection of frauds.

The detection of fraud is generally regarded as being of primary importance.”²⁶

Or as Lord *Denning* put it:

“An auditor is not to be confined to the mechanics of checking vouchers and making arithmetical computations. He is not to be written off as a professional ‘adder-upper and subtractor’. His vital task is to take care to see that errors are not made, be they errors of computation, or errors of omission or commission, or downright untruths. To perform this task properly, he must come to it with an inquiring mind — not suspicious of dishonesty, I agree — but suspecting that someone may have made a mistake somewhere and that a check must be made to ensure that there has been none.”²⁷

¶9-560 Formalities: (7) meetings. The Corporations Law contains numerous specific and technical requirements concerning company meetings, such as the notice which is to be given, voting procedures (including proxies), resolutions and minutes of proceedings. The members of a company as a body can generally act only through a general meeting (but see below), and it is with the general meeting that ultimate control of the company resides. The Corporations Law provides for:

- Directors’ meetings (Part 2G.1).
- Meetings of members of companies (Part 2G.2).
- A court-convened meeting (sec 249G).
- An annual general meeting for a public company (sec 250N).
- Class meetings, involving members of a class of shares such as for variation of rights and approval of schemes of arrangement (sec 411).

Shareholders and directors of public and proprietary companies with only one shareholder and/or director can “pass” resolutions simply by recording their decisions in writing (sec 248B and 249B).

The common law also affects meetings to a large extent: matters such as the powers of a chairperson are covered by the common law.

Proprietary companies. There are two important qualifications on the Law’s meeting requirements as they relate to proprietary companies:

- (1) proprietary companies need not hold annual general meetings (unlike public companies: sec 250N);
- (2) a proprietary company can “pass” a “circulating resolution” by having

26. Irish, RA, *Practical Auditing*, quoted by Fullagar J in *Frankston and Hastings Corporation v Cohen* (1960) 102 CLR 607 at p 617. The Australian auditing profession places detection of fraud as secondary to the primary duty of reporting whether the accounts are “true

and fair”: Gay, GE and Pound, GD, *The role of the auditor in fraud detection and reporting* (1989) 7 C & SLJ 116.

27. *Fomento (Sterling Area) Ltd v Selsdon Fountain Pen Co Ltd* [1958] 1 WLR 45 at p 61; [1958] 1 All ER 11 at p 23.

all its members sign a statement that they are in favour of the resolution — this overcomes the need to have a formal meeting (sec 249A);

¶9-570 Formalities: (8) dividends. The main aim of a trading company is to make a profit. Once made, the profit may be held in reserve, or it may be distributed to the shareholders. It is this distribution which usually takes the form of a dividend — a share of the profits allocated to shareholders of a company — which imposes another burden on company management. A trustee of a discretionary trust has just that discretion — to allocate or not. Company management has the power to recommend the payment of a dividend, but it is the company in general meeting which decides. If the general meeting so decides, the question of dividends is out of the hands of the directors.

¶9-580 Admission of new investor/participant into structure. One of the basic features of a company is that its capital is divided into shares, which are purchased by members of the company. Section 1085 of the Corporations Law provides that shares are transferable in the manner provided in the company's constitution or rules. Shares in publicly listed companies are transferable by instrument of transfer or electronically (¶5-030; ¶8-660; ¶13-420). Apart from the case of a company which has voluntarily imposed restrictions on the transferability of its shares (and many proprietary companies have such restrictions), there is no limit on the transfer and transferability of shares.

When shares are transferred, the transferee becomes a member of the company upon registration of the transfer and the person's name being entered in the register of members. In other words, this ability to acquire shares and dispose of them with ease gives the investor flexibility and is one of the distinguishing features of the corporate business form. It also gives the company flexibility in admitting new investors/participants by means of the purchase of existing shares or by a new issue of shares.

¶9-590 Ability to sell entire business interest. The fact that shares can be easily sold is one of the key features of a company. There are two main aspects of share ownership:

- the shareholder owns property (the shares, which are personal property (¶3-040) not real property); and
- ownership gives rise to membership of the company in which the shares are held.

On registration of the transfer of shares, if it is a proper transfer of shares, the transferee becomes a member of the company, with all the rights that membership brings.

Any restriction on transfer of shares will depend on the actual terms of the company's constitution or rules, but such restrictions would generally be viewed by a court to favour the right of a shareholder to transfer a holding

freely, because any restrictive provision is usually interpreted in favour of the party who is restricted by it.²⁸ For example, the constitution or rules may provide that the directors have the discretion to refuse to accept and register any transfer. As with any discretion, such a discretion must be exercised in good faith and for reasons the directors believe to be for the benefit of the company and for no other reason. If the directors refused to register a transfer of shares for irrelevant reasons, the shareholder concerned could obtain an order of the court against the directors.

Company law principles, then, provide no obstacles to transfer of shares. An extensive agreement to sell — where virtually the whole of the company's shareholding is transferred — may go beyond the realms of company law into law governed by Chapter 6 (Takeovers) of the Corporations Law or the *Trade Practices Act 1974* (Cth) sec 50 (mergers: ¶8-570). When a business is sold by means of a transfer of shares, the purchaser may well require some kind of warranty by the vendor/transferor as to what is being sold. What guarantee is there that the business nets \$100,000 pa? What warranty is there on the goodwill and trade contacts that go with a transfer of shares? Misleading answers on the sale of a business are actionable under the *Trade Practices Act*: ¶7-280.

¶9-600 The winding up process. The process of bringing a company to an end — winding up — requires compliance with the procedures and formalities detailed in Part 5.6 (sec 513ff) of the Corporations Law and the company's constitution or rules. Under this process, the assets are realised, the creditors paid out, the surplus (if any) distributed amongst the shareholders, and the company deregistered (¶13-559).

Winding up is the process whereby a company is prepared for deregistration, at which time the company's name is struck off the register and the company in effect goes out of existence. Not until this time does the company cease to exist, as the commencement of liquidation does not of itself terminate the company's existence. The company is, while being wound up, the same legal person as before with its control vested in a liquidator rather than the directors. Although a winding up ends their powers, the directors are still under an obligation to assist the liquidator.

When a company is in the course of being wound up, every invoice, order or business letter issued by or on behalf of the company or the liquidator must carry the words "in liquidation" after the company's name.

A winding up proceeds in this general manner:

- (1) The company passes a resolution or the court makes an order for the company to be wound up.
- (2) A liquidator is appointed and control of the company passes to the liquidator (¶9-625).

28. Under the *contra proferentem* rule of legal interpretation noted at ¶17-620.

- (3) The liquidator converts into cash all the company's assets, gets in so much of the uncalled capital as necessary to pay debts, and pays out all creditors. If the assets and uncalled capital are insufficient, the liquidator pays the creditors in order of priorities established by the Corporations Law.
- (4) If, after payment of winding up expenses and payment out of all creditors, any surplus remains, this is then distributed to the shareholders in accordance with the company's constitution.
- (5) The company is deregistered.

The winding up of a company is a complicated and prolonged affair, confused sometimes by protracted litigation, or at other times by uncompleted contracts. The task of getting in the assets is mostly a complicated one and the time it takes is better measured in years than months. Winding up may take various forms. It may be voluntary — at the instance of the members of the company or at the instance of the creditors — or it may be “involuntary”, ie by court order.

¶9-610 Winding up order. A company (whether or not it is being wound up voluntarily: ¶9-620) may be wound up under an order of the court on the application of (Corporations Law sec 462(2)):

- the company;
- a creditor of the company, including a contingent or prospective creditor;
- a contributory;
- the liquidator of the company;
- ASIC, under sec 462(2A);
- the Australian Prudential Regulation Authority (APRA).

Winding up in insolvency. Part 5.4 (sec 459ff) provides that the court may order the winding up of an insolvent company.

Winding up by the court on other grounds (Corporations Law Part 5.4A). Under sec 461(1), the court may order the winding up of a company if, for example:

- the company has resolved by special resolution to be wound up by the court;
- the company has not commenced business for a year after incorporation or has suspended its business for a whole year;
- the company has no members;
- the directors have acted in the affairs of the company in their own interest rather than in the interests of the members as a whole or in any other manner which appears unfair or unjust to other members;
- the affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member; or an act, omission, or resolution of a class of members is

oppressive or unfairly prejudicial to a member (these grounds for winding up correspond with the sec 232-235 remedy in cases of oppression or injustice);

- the court is of the opinion that it is just and equitable that the company be wound up. This “just and equitable” ground, comparable to equivalent law in the *Partnership Act* (¶10-540), gives the court a wide discretion to wind up a company for such reasons as the company not having achieved its purposes; fraud on the part of the company since incorporation; failure on the part of the company to carry on profitably; and deadlock, fraud, misconduct or oppression in management (sec 461(1)(k)).

¶9-620 Voluntary winding up. A company in financial difficulties has a number of options. It may enter a scheme of arrangement or it may be wound up by the court or voluntarily.

Voluntary administration. Voluntary administration allows directors to appoint an administrator to help struggling companies to trade out of their financial difficulties (Corporations Law Part 5.3A (sec 435ff)).

¶9-625 Company liquidators. The person appointed to wind up a company is the liquidator, appointed by a court (in the case of a court or compulsory liquidation), or by the creditors (creditors’ voluntary winding up) or the contributories as defined in sec 9 (members’ voluntary winding up). Liquidators must possess the necessary experience, capacity and qualifications and must be registered with ASIC (sec 532, 1279, 1282); cf ¶13-553.

The principal duties of a liquidator are:

“to take possession of and protect the assets, to make lists of contributories and creditors, to have disputed cases adjudicated upon, to realise the assets and to apply the proceeds in due course of administration amongst the creditors and contributories”.²⁹

More specifically, sec 477(1) provides that a liquidator may:

- carry on the business of the company so far as is necessary for the beneficial disposal or winding up of that business;
- pay any class of creditors in full (subject to the priority provisions contained in sec 556);
- make any compromise or arrangement with creditors or with persons claiming to be creditors;
- compromise any calls and liabilities to call, debts and liabilities capable of resulting in debts and any claims (present or future, certain or

29. *Re Partridge; Ex parte McDonald* (1961) 61 SR (NSW) 622.

contingent, ascertained or sounding only in damages) subsisting or supposed to subsist between the company and a contributory or other debtor or person apprehending liability to the company.

Section 477(2) sets out further powers, such as the power to bring or defend legal proceedings and the power to appoint a solicitor.

The Corporations Law imposes strict provisions on liquidators regarding the keeping of accounts, making application to the court for directions, and their personal liability for default, etc. Liquidators may certainly face liability under the common law for negligence (§4-230ff).

A liquidator is also empowered by the Corporations Law and the Rules of Court to examine the former directors, to make calls on shares and, of particular significance to creditors, to reject proofs of debt. One of the things a liquidator will do is examine the company's books, going back six months to identify possible preference transactions (§13-690—§13-705).

Comparisons may be made with receivers, appointed by debenture holders and other creditors (§13-553—§13-557).

¶9-626 Order of payment of debts on liquidation.

Distribution of the company's assets can commence after the assets have been collected and the time fixed for the proving of claims has passed. Although sec 555 provides that debts proved are to rank equally, its proviso "as otherwise provided" brings in provisions of the Corporations Law to establish the following basic order for payment of debts:³⁰

- (1) Practical matters such as telephone and power bills are usually first attended to.
- (2) Debts secured by a mortgage, charge or lien over the company's property.
- (3) Insurance moneys for third parties (sec 562).
- (4) Preferential creditors. Section 556 provides that (subject to sec 553-564, sec 9 "relevant date") in the winding up of a company the debts listed in the section are to be paid in priority to all other unsecured debts. The debts are, first, costs of winding up (sec 556(1)(a)), and then, in order, debts such as—
 - the expenses of the winding up applicant (sec 556(1)(b));
 - remuneration and debts of the administrator (sec 556(1)(c));
 - employee wages (sec 556(1)(e));
 - injury compensation (sec 556(1)(f));

30. This order of payment is similar to that applying to personal bankruptcy (eg §13-720). Corporations Law sec 553E

confirms the application of the provisions of the *Bankruptcy Act 1966* (Cth) to the winding up of an insolvent company.

- employee leave and retrenchment entitlements (sec 556(1)(g) and (h)).
- (5) Ordinary unsecured debts.
- (6) Deferred creditors.

ASSOCIATIONS

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¶9-630 Nature of structure and governing law. The law provides various possibilities for the organisation of an association:

- (1) *Unincorporated association.* An unincorporated non-profit association such as a club or society does not have to be formally incorporated under any legislation. At common law, an unincorporated association is recognised as a body of two or more persons set up to promote a common non-profit purpose. Making a profit may be incidental to the association, but it must not be its main object.
- (2) *Partnership.* In contrast, a partnership or firm is also an unincorporated association but by definition it is set up to make a profit (¶10-060).
- (3) *Incorporated company.* Incorporating as a company is another possibility for organising an association (¶9-270ff).
- (4) *Incorporated association.* The members of an association³¹ may choose to incorporate as an incorporated association under the associations

31. So long as there are at least, eg, 5 members (Vic); 7 (Qld).

incorporation legislation.³² Because some incorporated associations have annual revenue of over \$500,000 and assets over \$1m, modern regulation attempts to impose corporate disclosure and accountability without unduly burdening the volunteer members of small incorporated associations.

The associations incorporation legislation does not apply to an association which is formed for trading or for the pecuniary profit of its members, or which is a trade union or is a company under the companies legislation.

An association (or partnership) of more than 20 persons formed for the “acquisition of gain” must be incorporated as a company under the Corporations Law sec 115 unless declared by the Minister to be a profession or calling that may be carried on by an unincorporated association (or partnership) within the maximum numbers specified: ¶10-020. Section 115 prohibits the formation of an association of people who have mutual rights acting together, not an association of people with individual rights, so “all sorts of groups such as hospital auxiliaries with a little shop or orthodox churches selling candles or volunteer historical museums in small country towns selling artifacts” are not illegal associations under sec 115.³³

Associations — unincorporated and incorporated — can cover many activities such as the following:

- Clubs and societies.
- Learned societies with membership based on specialist qualifications.
- Cultural or sporting associations open to all enthusiasts.
- Associations with religious, patriotic or political interests.
- Professional and other associations with specific entry requirements.
- Charitable organisations with fund raising as an objective.

To this list can be added: youth, voluntary and community groups; pressure groups; political parties.

The members of an association should consider the benefits of incorporation outlined at ¶9-655.

32. *Associations Incorporation Act 1981* (Vic) as amended by the *Associations Incorporation (Amendment) Act 1997* (Vic), designed to increase standards of financial reporting; *Associations Incorporation Act 1984* (NSW); *Associations Incorporation Act 1981* (Qld) *Associations Incorporation Act 1985* (SA); *Associations Incorporation Act 1987* (WA); *Associations Incorporation Act 1964* (Tas); *Associations Incorporation Act*

1991 (ACT); *Associations Incorporation Act 1963* (NT). See generally Sievers, AS, *Associations and Clubs Law in Australia and New Zealand*, The Federation Press, 2nd ed, 1996; McGregor-Lowndes, M, Fletcher, K, Sievers, AS, *Legal Issues for Non-profit Associations*, LBC Information Services, 1996.

33. *Rural and Agricultural Management Ltd v West Merchant Bank Ltd* (1996) 14 ACLC 11 at p 17.

Associations set up for profit-making or trade or commerce, friendly societies, permanent building societies, credit unions, co-operatives and employer and employee associations are ineligible to be incorporated as associations.³⁴

An incorporated association is a “person” subject to the *Fair Trading Act* in each State and Territory which regulates, for example, misleading or deceptive conduct (§7-250).³⁵

¶9-650 Establishment. Preliminary considerations concerning the establishment of an association have been listed as follows:³⁶

- What purposes or functions is the proposed association intended to fulfil and are these objectives attainable?
- Is there a need for an association — a permanent need? Is an existing association performing the function, easily able to do this or already planning to do this? Did another body try to achieve this and fail — and, if so, why?
- Is it likely to attract membership and be supported?
- How will it be financed?
- Is the current enthusiasm to launch an association likely to be matched by sustained active work? Who is available to do the work? Have they suitable knowledge, experience, energy and temperament to do the work? Are they already much involved in other associations? Are they prepared to serve on the committee?
- Is there a successful similar association elsewhere whose advice and encouragement could be sought? Is there a national body with which affiliation could be arranged?
- What is the best time of the year for its operations to commence?
- Who are interested people, officials and organisations whose influence and/or support could be helpful to launch it?
- What name should be used (§12-010—§12-020)?

The next task of the promoters of an association, having formed a foundation committee and appointed a chairperson, is to formulate the set of rules or the constitution of the association. Model constitutions are freely available, but in practice often need to be precisely settled by the committee's lawyers to iron out possible ambiguities and potential problem areas. Various Commissions have issued model rules which may be used by incorporated

34. eg *Associations Incorporation Act 1984* (NSW) sec 7(2); 1981 (Qld) sec 7(1)(b), (c); 1985 (SA) sec 18(2), (3), (5), (6); 1991 (ACT) sec 14(2).

35. *Forbes v Australian Yachting Federation Inc* (1996) 131 FLR 241.

36. eg Horsley, MG, *The Law and Administration of Associations in Australia*, Butterworths, 1976, p 64.

associations. Some Acts prescribe certain matters that must be included in the constitution.

¶9-655 Advantages of incorporation under associations incorporation legislation. Although it is not mandatory to incorporate under the associations legislation, incorporation does result in at least the following advantages:

- An incorporated association can sue and be sued in its corporate name.³⁷
- An incorporated association can hold property in its corporate name without the necessity of appointing trustees.³⁸
- An incorporated association can enter into contracts in its corporate name.³⁹
- The liabilities of an incorporated association are enforceable against the association and not against the members (¶9-680) or the committee members (¶9-690) personally, unless so provided in the rules of the association.⁴⁰
- Liabilities of members and committee members are limited to outstanding fees.⁴¹
- The association can make a profit as long as that profit is not divided amongst its members.
- The association has the statutory power to invest and to deal with moneys not immediately required, and to raise or borrow money.

The certificate of incorporation is conclusive evidence of incorporation of the association, but it is not evidence of incorporation of a previous unincorporated association or the transfer of its assets from the trustees of an unincorporated association to the incorporated association.⁴²

In contrast, an unincorporated association does not have a separate legal existence, cannot sue and be sued in the association name,⁴³ cannot hold

37. Vic sec 14(2); NSW sec 15(2)(b); Qld sec 19(c); SA sec 20(3); WA sec 10(d); Tas sec 11(1); ACT sec 22(d); NT sec 9(1).

38. Vic sec 14(2); NSW sec 15(2)(d); Qld sec 20(2)(b); SA sec 20(3)(b); WA sec 11; Tas sec 11(1), 12(1); ACT sec 22(c); NT sec 9(1).

39. Vic sec 14(2); NSW sec 15(2); Qld sec 20(2)(a); SA sec 20(3), 25(h); WA sec 10; Tas sec 11(1); ACT sec 22; NT sec 9(1).

40. eg Vic sec 15(1) subject to the exception in sec 51(3); NSW sec 16(1); SA sec 21(2); WA sec 12; Tas sec 27; NT sec 21.

41. A committee member is personally liable in certain circumstances for the debts of an insolvent association: eg *Associations Incorporation Act 1984* (NSW) sec 38; SA sec 39A(5).

42. *Mune v Centro Argentino of Victoria Incorporated* [1996] 2 VR 82, noted (1995) 69 LJ 1261.

43. Because it has no corporate status. Instead, individuals (such as the executive committee) can represent the unincorporated association.

property in its name and cannot enter contracts in its name.⁴⁴ Further, legal liabilities are incurred directly by the members (§9-680), the committee members (§9-690) and/or the association's common fund (§9-700).

§9-660 Continuity of existence. Any generalisation on the continuity of existence of an unincorporated association must take into account the nature of the association. An informally constituted local table tennis club and a formally constituted professional football club or trade union share common ground in this regard, and the point on continuity of existence is simple: an association has no existence apart from its members from time to time. This means that in the absence of members the club's existence terminates (unless arrangements have been made to vest property ownership, etc in the committee members or other persons of continued existence).

In this regard, the difference between an incorporated company and an unincorporated association was noted by *Fullagar J* in 1959:¹

"That fundamental difference is that a corporation has 'perpetual succession': it maintains its identity and its personality notwithstanding changes in its membership which may occur from day to day. Its property does not belong to its members. But the property of a 'society' does belong to its members from time to time, and that property may be owned by entirely different persons [at different times]."

An incorporated association, on the other hand, is brought into line with an incorporated company by the associations legislation and is expressly vested with "perpetual succession".²

§9-670 Limitation of liability: unincorporated association.

The question of liability in an unincorporated association is complicated by the fact that the association has no independent legal existence. This means that the individuals who make up the membership may sue and be sued in their own names. If the property of the unincorporated association is held by trustees for the association, the trustees may sue and be sued with the right to indemnity from the property of the trust (the association). This results in different degrees of liability for the component parts of the association. It also raises the question of who can sue.³

44. See, for example, cases such as *Carlton Cricket and Football Social Club v Joseph* [1970] VR 487, and cases discussed in that decision; see also *Freeman v McManus* [1958] VR 15, where the Victorian Supreme Court held that a lease could not be taken out by an unincorporated association—in that case, the Australian Labor Party.

1. *Williams v Hursey* (1959) 103 CLR 30 at p 54. See also, Baxt, R, *The dilemma of*

the unincorporated association (1973) 47 ALJ pp 305, 306.

2. Vic sec 14(2); NSW sec 15(2)(c); Qld sec 19(a); SA sec 20(3)(a)(i); Tas sec 11(1); ACT sec 22(a); NT sec 9(1).

3. A representative action analogous to class action may be available to enable recovery of damages from the common fund. See §7-770—§7-780.

¶9-680 Liability of members: unincorporated association.

The liability of the members of an unincorporated association is limited to the amount of the subscription required by the rules of the association (unless there is a contrary intention expressed in the rules or the constitution). This is the principle of *de facto* limited liability:⁴ In the words of the court in a leading case:⁵

“Associations [are clubs] of a peculiar nature. They are societies, the members of which are perpetually changing. They are not partnerships; they are not associations for gain; and the feature which distinguishes them from other societies is that no member as such becomes liable to pay to the funds of the society or to anyone else any money beyond the subscriptions required by the rules of the club to be paid so long as he remains a member. It is upon this fundamental condition, not usually expressed but understood by everyone, that clubs are formed; and this distinguishing feature has been often judicially recognised.”

As noted at ¶9-655, the liability of the members of an incorporated association is limited by the associations incorporation legislation (for example) “except as provided in the rules of the incorporated association”.

¶9-690 Liability of committee members. The trend of case law has been to hold the committee members of an unincorporated association personally liable in contract to third parties.

— Case example —

The committee members (the president, deputy president and secretary) of the Lancashire Poultry Society were held liable in contract for damages flowing from the loss of fowls which had to be destroyed after they had been tested by the society for certain poultry diseases. The question facing the court was to choose from the various persons associated together under the umbrella of the society's name the persons most closely concerned with the society's contract-making function. The committee members argued that liability could not be pinned on them because contracts negotiated by them were made purely on behalf of the society; but this contention did not stand. It was held that the committee constituted the persons responsible because its members were entrusted with the function of directing the activities of the unincorporated body and of carrying them out. This included the performing of contracts and liability thereon. This was expressed by one of the majority judges:

“... [the function of the law] is to imply an intention on the plaintiffs' part to make their contract with the person or persons to whom alone in the circumstances of the case the law regards as the persons responsible. That cannot be the society, for it does not exist. The law, therefore, has to choose from the various persons associated together under the umbrella of the

4. eg Sievers, AS, *Associations and Clubs Law in Australia and New Zealand*, Sydney, Federation Press, 2nd ed, 1996, p 3.

5. *Wise v Perpetual Trustee Co Ltd* [1903] AC 139 at p 149.

society's name ... [T]he business men who accept the office of being on the executive council, seem to me to be the persons whom the law must regard as pledging their own credit in order to perform the duties which they voluntarily undertake for their so-called 'society'; just as do the committee men of a club."

— *Bradley Egg Farm v Clifford*⁶ —

Incorporation under the associations incorporation legislation overcomes this liability, and, as noted at ¶9-680, the liability of the members and the committee members acting within the rules is limited by the legislation, thereby bringing associations in line with the limited liability long available to members of an incorporated company (¶9-460).

This does not, however, take account of the special position of insolvent trading debts. These are debts incurred by an association at a time when it is insolvent (ie it incurs debts that it cannot pay). Committee members of an incorporated association are liable for insolvent trading in New South Wales and in South Australia.⁷ Arguably in all jurisdictions they are also liable for insolvent trading under the Corporations Law.⁸

¶9-700 Liability of the common fund. The liability of the committee of an unincorporated association may be offset by the exercise of an equitable lien (¶13-280) against the common fund.

— *Case example* —

A professional rugby league footballer with Canterbury-Bankstown, on a three-year contract with the club, was injured while training. He was not able to sue the club by name for workers' compensation, as the club had no legal existence, but he was successful in his claim against the committee of the club for the year in which he sued even though its membership was different from that of the year in which he was injured. The court recognised that the liability of the committee members could be offset by exercise of an equitable lien against the funds of the club, citing a recent article:

"Although it is beyond doubt that the existence of a right of indemnity against the association fund is assumed by every person who undertakes the duties of a committee member of a voluntary society there is surprisingly little direct authority in its favour."⁹

— *Peckham v Moore*¹⁰ —

Similarly, a lien (¶13-230ff) was created by virtue of a trust to allow recovery by committee members from the common fund in *Wise v Perpetual Trustee Co Ltd*¹¹ where committee member lessees were held to be trustees

6. [1943] 2 All ER 378, per Scott LJ at p 386; *Smith v Yarnold* [1969] 2 NSW 410; *Carlton Cricket and Football Social Club v Joseph* [1970] VR 487.

7. NSW sec 37-41; SA sec 49AD.

8. Corporations Law Pt 5.7, discussed in McGregor-Lowndes, M, Fletcher, K and Sievers, AS, *Legal Issues for Non-Profit*

Associations, LBC Information Services, 1996, pp 46-49.

9. Keeler, JF, *Contractual actions for damages against unincorporated associations* (1971) 34 MLR 615 at p 619.

10. [1975] 1 NSWLR 353.

11. [1903] AC 139.

entitled to be indemnified out of any property of the club to which their lien as trustees extended. As trustees, they had no right of indemnity against association members personally.

The availability of the common fund of an incorporated association is a matter to be determined by the rules of the association, and such availability may well be limited in line with the limited liability of the members and the committee members of an incorporated association (§9-680—§9-690).

¶9-710 Control. Incorporated associations must appoint a person — not necessarily a member — as a public officer to provide a point of contact for the association.

Management of an association — whether incorporated or unincorporated — is normally done by a committee whose powers and duties are spelt out in the association's rules:

- (1) The legal effect of this constitution will depend on the ordinary rules of contract, namely, whether the members agreed to be bound by the rules or by any variation passed in accordance with their provisions.
- (2) Agency principles (see Chapter 11) determine whether association members are responsible for acts of the committee on their behalf; but in the normal course of events, contracts by the committee or its members in carrying on the business of the association in the usual way will bind the committee personally, and the committee will be entitled to indemnity out of the association's funds.
- (3) The committee members of an association — incorporated or unincorporated — are in a fiduciary relationship with the association (§9-770) and, as such, must act in the best interests of the members of the association.

The common law and the associations legislation recognise the rights of association members to prevent oppression,¹² misapplication of funds, or other breaches of the contract of appointment of the committee members.¹³

However, on the basis of the High Court decision in *Cameron v Hogan*,¹⁴ the courts have insisted that there is no contractual or other relationship between the members of an association and the association or between themselves to give them standing to challenge decisions of the association.¹⁵ "These rulings excluded most members of associations, other than members'

12. *Popovic v Tanasijevec (No 5)* (2000) 34 ACSR 1, noted (2000) 74 ALJ 435.

13. *Buckley v Tutty* (1971) 125 CLR 353.

14. (1934) 51 CLR 358, criticised in (1992) 66 ALJ 751.

15. Sievers, S and Baxt, R, *The rights of members of an unincorporated association or a Victorian incorporated association to challenge decisions of management — a continuing defect in the law* (1984) 1 C & SLJ 3.

clubs, from recourse to the courts ... [*Cameron v Hogan*] is a particularly severe application of this rule.”¹⁶

The rule in *Cameron v Hogan* can be distinguished where enforceable contractual rights and duties exist between members or where the rules confer on members a proprietary right or interest in property of the unincorporated association.¹⁷

Legislation in some jurisdictions also contains provisions overcoming *Cameron v Hogan*. For example, sec 11(2) of the New South Wales legislation provides that upon incorporation the rules of the association shall constitute the terms of a contract between the members from time to time and the incorporated association.¹⁸

The legislation¹⁹ and administrative law principles (§1-160 — §1-165) further require an association to abide by the rules of natural justice, especially where the association adjudicates upon the rights of its members or destroys an existing right. A decision of an association or of an association’s appeal tribunal may be subject to supervision by the courts under the rules of administrative law²⁰ if it is of sufficient “public aspect”.²¹ But not all decisions of associations — especially those to do with internal management and private matters — can be taken to court.

¶9-715 Formalities. Formalities in the case of an incorporated association depend upon the nature of the association and its constitution. In general, and as a minimum, formalities will at least match those of a sole trader (§9-090).

Incorporated associations must keep proper accounting records, which in most jurisdictions have to be audited.²²

Some jurisdictions, such as Victoria (following the 1997 amendments) and South Australia, have a “two tier” system of regulation, where incorporated associations with gross receipts of more than \$200,000 are required to lodge annual returns and accounts with the regulator (in Victoria, the Registrar of Incorporated Associations; in South Australia, the Corporate Affairs

16. Fletcher, KL, *The law relating to non-profit associations in Australia and New Zealand*, Sydney, The Law Book Co Ltd, 1986, pp 75-76.

17. *Plenty v Seventh-Day Adventist Church of Port Pirie* (1986) 43 SASR 121.

18. *Associations Incorporation Act 1984* (NSW). *Associations Incorporation Act 1981* (Qld) sec 41(1); 1985 (SA) sec 23; 1981 (Vic) sec 14A; 1991 (ACT) sec 48.

19. eg Qld sec 41(3); SA sec 40; ACT sec 50.

20. eg *Re Western Australian Trotting Association; Ex parte Chambers* (1992) 9 WAR 178 (writ of *certiorari* (§1-165) issued by court to quash decision by the

Racing Penalties Appeals Tribunal, on appeal from the Stewards of the WA Trotting Association).

21. eg *Re Maggacis* [1994] 1 Qd R 59 (the dispute between the applicant and the Queensland Netball Association was not justiciable); *Gamilaroi Boomerangs v Members of New England Group* 19 [1999] NSWSC 495, noted (1999) 73 ALJ 559.

22. Qld sec 30-31; Tas sec 24; SA sec 35. In the ACT and the NT an audit is called for by sec 71-80 and sec 25 (respectively), but there is no requirement that it be carried out by a registered auditor.

Commission (*not* ASIC)). The accounts must have been audited by a registered company auditor.²³

South Australian incorporated associations with gross receipts under \$200,000 are not required to lodge annual returns or to be audited. In Tasmania, incorporated association accounts must be audited by a registered company auditor, or by such other person as is approved by the Commissioner for Corporate Affairs.

In most jurisdictions, incorporated associations are required to call an annual general meeting at least once a year, the accounts and other financial statements being presented at that meeting.

¶9-720 Admission/expulsion of member/participant. The rules of an incorporated association provide for admission of a new member, but they must be read in the light of the rules of contract, natural justice, *ultra vires* and the judicial review of administrative decisions.

— *Case example* —

The management committee of an incorporated association decided to expel P. P successfully challenged this decision on the grounds that the committee was not validly appointed and that the decision to expel was void. The court conceded that the rules of natural justice (¶1-165) could be excluded from the operation of an incorporated association. However, in this case they had not been excluded and, because they had not been followed, P's expulsion was void.

— *Andricciola v Italian Community of Keilor Association Incorporated*²⁴ —

¶9-730 Ability to sell entire business interest. As an unincorporated association has no legal existence or legal personality, it cannot contract in its own name and contracts purportedly entered into with unincorporated associations may be of no binding legal effect.²⁵ This proposition has to be read according to the facts of the case and if the necessary contractual intention can be shown on the part of the parties (¶5-050) then a contract can be made with an association by way of its committee members personally, or all of its members at the relevant time. In these circumstances the courts will strive to uphold the contract.

Of course, capacity to contract is established in the case of an association incorporated under the associations incorporation legislation (¶9-655), and therefore the only factor affecting the ability to sell an association (incorporated or unincorporated) will be the words of the association's rules — is a vote of members necessary? what percentage of membership approval is required? and so on.

23. Vic sec 30A, 30B; SA sec 35-38.

24. [1996] 1 VR 421, noted (1995) 69 LIJ at p 1263.

25. As was shown in *Freeman v McManus* [1958] VR 15; *Carlton Cricket and Football Social Club v Joseph* [1970] VR 487, noted 45 ALJ 38.

¶9-740 Winding up. Winding up of an association is covered by different areas of law depending on the nature of the association itself:

- Associations incorporation legislation in some jurisdictions provides for the machinery of the Corporations Law (¶9-600—¶9-620) to be applied to the winding up of an incorporated association.²⁶ For example, sec 41(2) of the South Australian Act²⁷ applies several Parts of the Corporations Law²⁸ as if they were incorporated into the South Australian Act. Also, Part 5.7 (sec 582-588) of the Corporations Law provides some regulation for the winding up of associations (and other bodies which are not companies) of more than five members (such as a mutual aid society), which is in addition to any other relevant law.²⁹
- Some jurisdictions provide their own rules for winding up by the Supreme Court.³⁰
- A society operating under its own constitution and rules will be wound up according to the matters provided in those documents. These will provide for the method of dissolution either by the action of a group of the members or in the situation where membership falls below a specified number. In general, the constitution and rules should provide for the service of notice on members to call a general meeting, the procedure and the method as well as the priorities in application of funds, disposal of assets and the records to be kept on dissolution.³¹
- A society whose true legal status is that of a non-profit company permitted to dispense with “limited” in its name (sec 150 of the Corporations Law) is governed by the provisions of the Corporations Law regarding its winding up.
- Associations created by Royal Charter will be wound up upon the revocation of the Royal Charter, ie by Royal Assent (as is necessary for any variation in the association’s constitution and rules).

TRUSTS

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Definitions relevant to trusts	¶9-760
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26. eg NSW sec 50; Qld sec 44-46; SA sec 41; Tas sec 32; WA sec 30-32; NT sec 20.

27. Also, eg, Qld sec 45-46; WA sec 31.

28. Parts 5.4B, 5.5, 5.6, Div 1 and 2 of Part 5.7B, and Div 3 of Part 5.9.

29. This is incorporated by, eg, NSW sec 51; Vic sec 33; Tas sec 32; ACT sec 90-91; NT sec 20.

30. eg NSW sec 51; ACT sec 90.

31. eg Keay, A, *Winding up incorporated associations in Queensland: process and problems* (1994) 15 QL 91; Sievers, *op cit*, p 150.

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¶9-750 Nature of structure. Trusts are ancient devices (going back at least to the thirteenth century) originally providing for the preservation of family assets and the maintenance of widows and orphans. Their revival in modern business law is largely tax driven, and in fact wholly consistent with their original use, and tax planning and limitation of legal liability to creditors (through the use of a \$2 company as trustee — ¶9-790, ¶9-885) provide additional explanation for their current popularity.

The important difference between a trust and a company or partnership is that the trust has neither a separate legal identity (as has a company) nor does it involve a contractual relationship between all the persons in it (as does a partnership).³² Though there is a contractual relationship between the settlor and the trustee, the rights of the beneficiary do not necessarily arise from contract but from rules of equity (¶1-010). Likewise, where the deed of appointment is silent, the duties of the trustee are similarly provided for in principles evolved in the equity courts.

32. The trusts discussed in this chapter are to be distinguished from "trusts" in US anti-trust law, which were arrangements where company shareholders transferred their shares to trustees of voting trusts

in consideration of a share of the pooled earnings. These voting trusts were designed to retain corporate control, and came to mean any suspect business combination.

¶9-755 Types of trusts. Trusts may be classified as express and non-express, private and public.

Express trusts. Also called a “declared” trust or a “direct” trust, an express trust is a trust created by the express and the intentional declaration of the settlor (in contrast to non-express trusts, below). This declaration of intention is usually in the form of an instrument such as a deed (¶5-040) although in some cases the act or conduct of a party may be sufficient to indicate the necessary intention. This chapter is mainly concerned with express trusts. Express trusts may be classified as:

(a) *Discretionary trusts and fixed trusts.* A trust under which the identity or the interest of the beneficiary or beneficiaries is not determined at the creation of the trust is called a discretionary trust, as the trustee is able to exercise a discretion regarding choice of beneficiary or object and/or proportion of trust fund or trust interest each is to take. The advantages of a discretionary trust are set out at ¶9-780. In contrast, a fixed or non-discretionary trust is a trust where the trustee is not required to exercise any discretion regarding which beneficiary should receive trust property and in which proportion or amount, such as a declaration of trust to X and Y equally.

(b) *Executed trusts and executory trusts.* An executed trust is a trust in which the intentions of the settlor have been completely declared so that the trustee’s primary duty is to act in accordance with the terms of the trust, and the extent of the fiduciary obligation can be determined without recourse to a further instrument or document. A trust will be executory where some further act or instrument is necessary to complete the fiduciary obligation, and although the trust is a valid trust the extent of the obligation is not specified in that the interests arising in the trust have not yet been delineated.

(c) *Bare trusts and special trusts.* Express trusts can be further categorised as bare trusts and special trusts. A bare trustee, or the trustee of a bare trust (also called a passive trust or a simple trust) acts only as a repository of property and has no active duties to carry out beyond vesting the trust property in the beneficiaries at the direction of the beneficial owner.

(d) *Constituted trusts and incompletely constituted trusts.* A trust may be incompletely constituted in that the trust property has not been completely vested in the trustee. In this case the fiduciary relationship is regarded as being merely an agreement to constitute a trust which may be enforceable if supported by consideration (¶5-400ff). Where the property which is to be subject to the fiduciary relationship is completely vested in the trustee, the trust is regarded as a constituted trust.

Non-express trusts. A non-express trust is a trust created without express and intentional declaration and communication by the settlor. Non-express trusts can take the form of an implied or resulting trust and/or a constructive trust.

(a) *Implied or resulting or presumptive trust.* An implied trust, resulting trust or presumptive trust arises when the law implies or presumes an intention on the part of the settlor to create a trust. (Intention may be unexpressed.)

— *Examples* —

- (1) Person transferring title who does not intend to transfer beneficial interest: if a person contributes to the purchase of property but is not recorded as the owner, equity law presumes that the legal owner holds the property for the person paying.³³ The person paying has an equitable interest, and the property “results” to that person. If two or more have contributed, equity presumes that the person holding the legal title holds the property in trust for them in the shares in which they contributed.
 - (2) Person transferring title who does not intend to transfer beneficial interest: if the purchaser of property arranges for ownership to be in the name of a third person, the third person is deemed to be a trustee of the property for the purchaser.
 - (3) Failure to exhaust the whole beneficial interest: if the settlor provides that property is to be held on trust for the beneficiary for life but there is no mention of what happens after the beneficiary’s death, the beneficial interest in property which has not been disposed of reverts or “results” to the settlor on the beneficiary’s death.
 - (4) Failure of express trust: if an express trust fails (eg for uncertainty), the trust reverts or “results” to the settlor.
-

In the words of the High Court, “Where, on a purchase, a property is conveyed to two persons, whether as joint tenants or as tenants in common, and one of those persons has provided the whole of the purchase money, the property is presumed to be held in trust for that person, to whom I shall, for convenience, refer as ‘the real purchaser’.”³⁴

— *Case examples: resulting trusts and illegal purposes* —

Stella Tinsley (P) and Kathleen Milligan (D) lived together in a house which they paid for from money earned in the bed-and-breakfast business which they ran together. The house was in the name of P only, who was the sole legal owner, but they regarded the house as their joint property. Later P and D quarrelled, P moved out, and D remained in possession. D offered P a half share of the house, but P claimed possession of the whole house. The court upheld a resulting trust in favour of D for one-half of the property: “[D] established a resulting trust by showing that she had contributed to the purchase price of the house and that there was common understanding between her and [P] that they owned the house equally. She had no need to allege or prove *why* the house was conveyed into the name of [P] alone, since that fact was irrelevant to her claim: it was enough to show that the house was in fact vested in [P] alone.”

In fact, the reason why the house was in the name of P only was to allow D to make false claims for social security benefits by enabling D to answer

33. As in *Nelson v Nelson* (1995) 184 CLR 538, noted (1997) 71 ALJ 185 (where the beneficiary’s illegal purpose did not prevent relief in equity: ¶5-825).

34. *Muschinski v Dodds* (1985) 160 CLR 583, per Gibbs CJ at p 589.

“no” to the question “Do you own your own home?”. D was prosecuted, convicted and fined and paid back some money for the social security fraud. D’s claim for one-half of the house succeeded as she was able to prove her case without relying on the illegal purpose.

_____ *Tinsley v Milligan*³⁵ _____

Mrs N bought a house in the names of her adult son and daughter as joint tenants (¶13-160). Because technically she did not “own” a house, she was able to qualify for a subsidised war widow’s loan from the Commonwealth which she used to buy a second house. When she sold the first house, her daughter disputed her claim to the profits. The High Court found that a resulting trust arose in favour of Mrs N due to her intentions at the time of purchase, even though the purpose was to circumvent the legislation. Because Mrs N’s purpose was illegal, the High Court required her “to do equity according to the requirements of good conscience” by restoring the interest advantage she had received by her false statement. In addition, Mrs N faced the likelihood of prosecution and an order to reimburse the Commonwealth, but this had not happened at the time of this case.

_____ *Nelson v Nelson*³⁶ _____

The presumption of a resulting trust may be rebutted on the facts, such as by evidence that a de facto wife intended to give her de facto husband an immediate and unconditional beneficial interest in real estate to her exclusion.³⁷

(b) *Constructive trust*. An express trust, and an implied or resulting trust, arises from the express or implied intention (respectively) of the parties. In contrast, a constructive trust is imposed by equity law to hold one person (a legal owner) accountable to another person (an equitable owner) in various situations where it would be inequitable not to do so, such as:

- where in equity it would be a fraud for a person to deny the trust, or
- where there has been unconscionable conduct.³⁸

The word “constructive” is derived from “construe” not “construct”, so the court construes the circumstances to explain or interpret them: it does not construct the circumstances giving rise to a constructive trust.³⁹

Examples of constructive trust

A constructive trust arises where:

35. [1994] 1 AC 340 at 376 (HL), noted (1997) 71 ALJ 185.

36. (1995) 184 CLR 538, noted (1997) 71 ALJ 185.

37. eg *Muschinski v Dodds* (1985) 160 CLR 583, below.

38. Dal Pont, GE and Chalmers, DRC, *Equity and Trusts in Australia and New Zealand*, LBC, 1996, Ch 26.

39. *Giumelli v Giumelli* (1999) 196 CLR 101; (1999) 73 ALJR 547. Because there was an equitable remedy falling short of imposing a constructive trust — in this case, promissory estoppel — there was no need to impose a constructive trust: ¶5-485.

- (1) two people such as de facto spouses buy property in the name of one only, but both contribute to the purchase price (see *Muschinski v Dodds* below).
- (2) a fiduciary (§9-770, §10-370) receives an unauthorised gain such as where:
 - a partner renews a partnership's lease in the partner's own name to the exclusion of the others (§10-570), or
 - a trustee makes an undisclosed profit from the trust.
- (3) an outsider or a stranger to the trust profits by getting involved in trust matters.⁴⁰
- (4) a stranger receives and deals with trust property knowing that it is in breach of trust, such as where:
 - a bank pays trust moneys into a running overdraft account;
 - a director of a company dishonestly assists in a breach of trust by the company.⁴¹
- (5) a vendor of land holds the land as constructive trustee for the purchaser.
- (6) a murderous beneficiary, who loses any claim to the property under the forfeiture rule (§12-200), may have an entitlement to property under a constructive trust.⁴²

— *Case examples* —

D, a senior law officer, in breach of fiduciary duty to the government, accepted bribes to obstruct the prosecution of certain criminals. D was arrested, charged with various criminal offences, sentenced and jailed. The court confirmed that in this situation:

- D became a debtor of the government for the amount of the bribe, and
- D held the bribe and any property acquired therewith on constructive trust for the person to whom the duty was owed (in this case, the government).

“Where a bribe is accepted by a fiduciary in breach of his duty then he holds that bribe in trust for the person to whom the duty was owed. If the property representing the bribe decreases in value the fiduciary must pay the difference between that value and the initial amount of the bribe because he should not have accepted the bribe or incurred the risk of loss. If the property increases in value, the fiduciary is not entitled to any surplus in excess of the initial value of the bribe because he is not allowed by any means to make a profit out of a breach of duty.”

— *Attorney-General for Hong Kong v Reid*⁴³ —

40. ie by acting as trustee of his own wrong or “a trustee de son tort”.

41. *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 WLR 64 (PC); §9-480.

42. Sparke, C, *Murderous beneficiaries — should they take the benefit?* (1998) 72(1) LIJ 53.

43. [1994] 1 AC 324 at pp 331-332.

Resulting trust or constructive trust? A de facto couple, Ms P and Mr D, bought land as tenants in common in equal shares (¶13-190), with Ms P contributing about 90% of the purchase money. When they separated, Ms P claimed that she was the beneficial owner of all the land; Mr D claimed a half-share.

Resulting trust. The High Court held that any presumption of a resulting trust in favour of Ms P was rebutted by evidence that Ms P intended to give Mr D an immediate and unconditional beneficial interest in the property in return for his input in the form of assisting her in her business and building a house from his funds.

Constructive trust. However, the High Court declared that a constructive trust existed to the effect that Ms P and Mr D held the land as tenants in common in trust to repay their respective contributions and to share the residue equally.

*Muschinski v Dodds*⁴⁴ —

Private trust and public trust. Trusts can also be divided between private trusts (for the benefit of private individuals — which may be express or non-express) and public trusts (to benefit public purposes, or more generally, the public welfare such as a trust for the benefit of a specific charity). The emphasis in this chapter is on private trusts.

¶9-760 Definitions relevant to trusts. A trust is recognised as the obligation contained in the relationship whereby person B (the trustee) holds property transferred by person A (the settlor) for the benefit of (in trust for) person C (the beneficiary). More formally put:

“A trust may be defined as an obligation enforceable in equity which rests on a person (the trustee) as owner of some specific property (the trust property) to deal with that property for the benefit of another person (the beneficiary) or for the advancement of certain purposes.”⁴⁵

A trustee may be one of several beneficiaries or a beneficiary may be one of several trustees.

A trust involves a fiduciary relationship (¶9-770) in which the trustee is the holder of an interest in property but is subject to an equitable obligation to use or to keep that property for the benefit of another person or persons (the beneficiaries) or for some object or purpose (¶13-210).

Traditionally, the trust has worked in such a way that a settlor might pay say \$10,000 to the trustee to invest in blue chip securities, the income from the investment to be paid to the beneficiary for life and on the beneficiary's death the securities to be sold and the proceeds to be divided

44. (1985) 160 CLR 583; also *Baumgartner v Baumgartner* (1987) 164 CLR 137.

45. Ford, HAJ and Lee, WA, *Principles of the Law of Trusts*, Sydney, The Law

Book Co Ltd, 2nd ed, 1990, p 3; Ford, HAJ and Lee, WA, assisted by McDermott, P, *Principles of the Law of Trusts* (loose-leaf), LBC, 1996.

amongst the beneficiary's children. Trusts such as this can be created by will, settlement or express declaration by deed.

The five major elements which make up a trust are: the settlor, the trustee, the beneficiary, the trust property and the personal obligation attached to the trust property:

(1) The *settlor* is the person who, in the case of an express trust, causes the trust relationship to come into being; in this case there is a specific intention by a person to create a trust. The settlor is often referred to as a *creator*. In the case of *inter vivos* gifting — between living people — the settlor is the *donor* or, in the case of dispositions upon death, the *testator*.

Where a trust is created unintentionally (ie there is no implied or presumed intention) there will be no settlor — these trusts are generally referred to as constructive or implied or resulting trusts (§9-755). A settlor may at the one time be, in addition, a trustee and a beneficiary. Where a person simply declares that property is to be held in trust for another person then that person is both settlor and trustee. However, where the settlor or trustee is a beneficiary there will be no valid trust created unless there is another person specified, or within a specified class, who can be a beneficiary.

(2) The *trustee* is the person in whom the trust property is vested. In most cases where a trust is expressly created, a specific trustee (which may be a trust company) is designated. In addition, a person may become a trustee through the operation of law even though there is no instrument designating him as such, as in the case of a constructive, implied or resulting trust.

(3) The *beneficiary* is the person who benefits under the fiduciary relationship. The beneficiary is also referred to under the old law-French (§3-040) title of *cestui que trust*. There may be a valid trust even though the beneficiary be an unborn person or a group or class of persons whose exact identity at the time of the trust creation cannot be determined. In the case of charitable trusts it is not necessary that there be a beneficiary, just a proper charitable purpose or object.

(4) There must be some specific *trust property*, or an interest in some specific property, which can be subject to a trust. This requirement distinguishes the trust relationship from that of other fiduciary relationships, for example, that of a partner to fellow partners.

The trust property is generally referred to as *corpus* or the subject matter of the trust. The nature of the property is irrelevant; it may be intangible or tangible, personal or real, a chose in possession or a chose in action (§3-020—§3-040). In addition, the trust property may be equitable as opposed to legal (§3-210ff); for example, there is no reason why there cannot be a trust of property which is itself subject to a trust.

(5) The *personal obligation* of the trustee refers to the duty owed by the trustee to the beneficiaries. The trustee is the legal owner of the trust property — the beneficiaries are the equitable owners (§3-210). The trustee is subject to a fiduciary duty (§9-770), enforceable by the beneficiaries in equity, to use or to keep the trust property for the benefit of the beneficiaries.

The *trust instrument*, in the case of a private express trust, is a document (often a deed: ¶5-040) by which property which is to be subject to a trust is vested in the trustee and the beneficiary. In addition, the trust instrument may set out the rights and duties of the parties.

¶9-770 Fiduciary relationship. A fiduciary relationship is at the centre of the trust relationship, but it is not limited to trusts. “[P]ersons in trusting relationships are identified as fiduciaries on account of what they agreed to, undertook, or are taken to have assumed.”⁴⁶

A fiduciary relationship is a relationship of trust and confidence, which arises when one person is bound to act in good faith and in the interests of another person.

The fiduciary relationship arises from two sources: (1) agency, and (2) a relationship of ascendancy or influence or dependence on trust.

The trustee as a fiduciary has a duty of confidence, honesty, and responsibility to act for the benefit of the beneficiary. This fiduciary relationship would be breached if a trustee acted for private advantage or for the advantage of a person who was not a beneficiary and, as a result, the beneficiary became disadvantaged or suffered some detriment.

A court of equity would not allow a person in a fiduciary position to make a personal profit (unless expressly entitled) or to be placed in a conflict of interest situation.⁴⁷

Features of a fiduciary relationship. Three features identify a fiduciary relationship:⁴⁸

(1) A relationship of trust and confidence such as trustee/beneficiary or partner/partner. There must be a situation, such as a trustee’s acceptance of the trusteeship, where one person is obliged or has undertaken to act in the interests of the other (and not in their own interests), and where that person has the power to affect the interests of the other in a legal or practical way.⁴⁹

“The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.”

46. Glover, J, *Commercial Equity — Fiduciary Relationships*, Sydney, Butterworths, 1995, p 32.

47. *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at pp 96-97, cited eg in *Mabo v Queensland* (1992) 66 ALJR 408, per Toobey J at p 491.

48. Based on Dal Pont, GE and Chalmers, DRC, *Equity and Trusts in Australia and New Zealand*, LBC, 1996, pp 39-41.

49. *Hospital Products case*, per Gibbs CJ at CLR p 68.

Often the relationship involves a person entrusting property to a fiduciary, such as leaving share scrip with a stockbroker.

However, not all undertakings to act in the interests of others involve a fiduciary relationship, and there need not be an actual relationship of confidence for a fiduciary relationship to arise.

(2) A relationship with disadvantage, vulnerability and unequal bargaining power on the part of one person which was the cause of placing reliance on the other. Equity law will protect the weaker person from abuse of position by the other.

(3) A relationship of reliance, where one person may rely or may be entitled to rely on the other due to the relationship of trust and confidence, such as reliance on a business partner or a bank manager.

Relationships which give rise to fiduciary obligations. The following relationships are traditionally recognised as fiduciary, and as such they give rise to fiduciary obligations:⁵⁰

- executor and beneficiary (§3-730);
- company promoter and the company (§9-400);
- company director and the company (§9-480);
- committee and members of an association, whether incorporated or unincorporated (§9-710);
- trustee and beneficiary (§9-760);
- solicitor and client — a solicitor must always act in the interest of the client;
- partners (§10-370), including the period after dissolution of the firm (*Chan v Zacharia* §10-570);
- principal and agent (§11-180—§11-190);
- stockbroker/financial adviser and client (§11-180),⁵¹ and
- guardian and ward.

— Case examples —

Solicitors acting for borrowers advised the borrowers that a mortgage would be available from the bank. In fact, the solicitors had acted as intermediaries, by arranging bridging finance from the bank and by issuing the mortgage in their own name, with full disclosure of their name as mortgagees. When the borrowers defaulted, the solicitors/mortgagees commenced proceedings for recovery. One defence of the borrowers was that the solicitors were in breach of their fiduciary duty to them, and this was upheld by the primary judge, who “set aside” the mortgage. On appeal, the High Court upheld the borrowers’ equity to have the transaction rescinded and made an order returning the parties to their original position. The borrowers were ordered

50. Dal Pont and Chalmers, *op cit*, pp 44-71.

51. Unless the relationship is “non advisory” or “execution only”.

to “do equity by honouring their contractual obligations to pay the money and interest secured by the Mortgage”. The rate of interest was lowered from the then bridging loan rate of 22% (which was the rate in 1989) to the current commercial rates.

— *Maguire v Makaronis*⁵² —

A company director arranged for creditor companies connected with his family to be paid before the company of which he was a director. He then resigned the directorship to “sanitise” his actions. The court held that a company director cannot avoid a breach of fiduciary duty by resigning the directorship.

— *Addstead Pty Ltd v Liddan Pty Ltd*⁵³ —

Situations which give rise to fiduciary obligations. Certain situations outside the recognised fiduciary relationships listed above may give rise to fiduciary obligations if they have the characteristics of a fiduciary relationship:

- joint venturers, as in the *Brian case* and in the *Dickson Hotel case* (¶9-140).
- banker and customer (¶16-060). This relationship is that of debtor and creditor, but the bank may assume fiduciary duties when giving advice.
- manufacturer and distributor, as in the *Hospital Products case*:

— *Case example* —

After appointment by B (a US Manufacturer), T (its Australian distributor) developed its own manufacturing capacity by copying B’s product, and began supplying B’s Australian customers with T-labelled products, leading customers to believe that this supply was done by arrangement with B. T later cancelled its agency with B and notified its customers that it was substituting Australian-made products for the earlier lines made in the US. When B learned of T’s activities, legal proceedings were commenced for breaches of sec 52 and 53 of the *Trade Practices Act 1974* (Cth) (¶7-250; ¶7-290), passing off, infringement of copyright, breach of confidence, unfair competition and other alleged wrongs. The High Court held in favour of B for breach of contract by T by its action in deferring fulfilment of orders for B’s products to substitute its own, by substituting its products at the expense of those of B, and by secretly developing its own manufacturing capacity to appropriate B’s market. However, the court rejected the existence of a fiduciary relationship between T and B in view of the commercial character of the parties’ arrangement because of their having dealt at arm’s length and on an equal footing.

In particular, three factors were raised by *Gibbs* CJ to help define the presence of a fiduciary relationship.⁵⁴

- (1) The existence of a relation of confidence which may be abused:

“However, an actual relation of confidence — the fact that one person subjectively trusted another — is neither necessary for nor conclusive of the existence of a fiduciary relationship; on the one hand a trustee

52. (1997) 188 CLR 449; (1997) 71 ALJR 781.

53. (1997) 15 ACLC 1687.

54. (1984) 156 CLR 41 at pp 69-70.

will stand in a fiduciary relationship to a beneficiary notwithstanding that the latter at no time reposed confidence in him, and on the other hand an ordinary transaction for sale and purchase does not give rise to a fiduciary relationship simply because the purchaser trusted the vendor and the latter defrauded him.”

- (2) Inequality of bargaining power, but that alone is insufficient.
- (3) The existence of a purely commercial relationship, with dealings at arm's length on an equal footing, or a statutory duty to perform certain functions, is not necessarily inconsistent with a fiduciary relationship.

— *Hospital Products Ltd v United States Surgical Corporation*⁵⁵ —

- employer and employee.

— *Case example* —

P was the Australian distributor of products made in Italy. P's general manager (D), afraid that his position would be downgraded, secretly negotiated to take over P's distributorship from the Italian manufacturer by setting up two companies. When the Italian manufacturer cancelled its agency agreement with P and transferred it to D's companies, P successfully sued D for an account of profits.

— *Warman International Ltd v Dwyer*⁵⁶ —

- parent and child.⁵⁷

Possible future fiduciary relationships

- government and aboriginal citizens. This relationship is trust-like, on the basis of the Government's historical powers (for example, the power to extinguish native title) and its assumption of responsibility for peoples within its protection, but in Australia it has not yet been accepted as fiduciary.⁵⁸
- doctor and patient. At present, there is no fiduciary relationship which requires a doctor to give access to medical records to a patient.⁵⁹

Fiduciary duties. The duties of a fiduciary can be summarised as follows (compare ¶9-880):⁶⁰

- (1) the “no conflict” rule — not to be in conflict with the beneficiary;
- (2) the “no profit” rule — not to profit at the expense of the beneficiary;

55. (1984) 156 CLR 41; (1984) 58 ALJR 587, noted (1985) 59 ALJ 670.

56. (1995) 182 CLR 544; (1995) 69 ALJR 362, noted (1995) 69 ALJ 782.

57. eg *Johnson v Department of Community Services* [1999] NSWSC 1156; (2000) Aust Torts Reports ¶81-540.

58. eg *Thorpe v The Commonwealth* (1997) 71 ALJR 767 at p 775. This relationship

has been accepted as fiduciary in Canada and the US.

59. *Breen v Williams* (1996) 186 CLR 71, noted (1997) 71 ALJ 332.

60. The Law Commission, *Fiduciary Duties and Regulatory Rules*, Consultation Paper No 124, London, HMSO, 1992, p 32; Report, 1995.

- (3) the undivided loyalty rule — including making available to the beneficiary all information relevant to the beneficiary;
- (4) the duty of confidentiality — information obtained for the beneficiary must not be used by the fiduciary for private advantage (§3-685).

Remedies for breach of fiduciary duty. Remedies against fiduciaries in breach include:

- (1) injunction — an order to prevent breach by a fiduciary: §6-410.
- (2) constructive trust. Equity law may impose a constructive trust for breach of fiduciary duty: §9-755.
- (3) equitable lien — where equity recognises that a creditor has the right to have property of the debtor applied to payment of the debt: §13-280, §13-290.
- (4) account of profits. Profits generated as a result of the breach by the fiduciary may be apportioned, so that the beneficiary does not unfairly gain from the efforts of the fiduciary.⁶¹
- (5) equitable compensation — financial indemnity for losses caused by a fiduciary's breach of duty. This resembles an order of damages at common law, but is not limited by the common law rules of remoteness, foreseeability and causation (§6-420ff).
- (6) equitable damages. The ability of an equity court to grant an award of damages, which is the main remedy at common law, was originally provided for in English legislation in "Lord Cairns' Act" in 1858⁶² and its Australian equivalents.⁶³ An award of damages may include exemplary damages: §4-200.
- (7) interest, either compound or simple.
- (8) rescission — an order to set aside a transaction.

Third parties. There may be legal (as distinct from equitable) remedies available against third persons where there has been breach of a fiduciary duty, including:⁶⁴

- (1) action for "money had and received", ie an action to account;
- (2) common law tracing — this provides evidence for action in conversion or "money had and received".
- (3) action in the tort of conversion.

Equitable remedies against a third party include:

- (1) equitable tracing — to locate the property.
- (2) accounting as a constructive trustee.

61. *Warman's case* (1995) 182 CLR 544.

64. eg Glover, *op cit*, Chapter 7, fn 1.

62. *Chancery Amendment Act 1858* (UK).

63. eg *Supreme Court Act 1970* (NSW) sec 68;
1986 (Vic) sec 38; 1935 (SA) sec 30; 1979
(NT) sec 62.

¶9-780 Advantages and disadvantages of the discretionary trust

Advantages in setting up a discretionary trust include:

- flexibility of operation. As the settlor has settled income-earning property on the trustee, it is the trustee who has the “discretion” of management, including choosing to whom a distribution should be made from a range of named beneficiaries, potential unnamed beneficiaries and/or more general “objects” (such as an anti-logging group);
 - non-enforcement by unnamed beneficiaries.
 - In some discretionary trusts, the beneficiaries are named and may have the right to enforce the trust against the trustee.
 - In other discretionary trusts, the beneficiaries are unnamed and therefore their right to enforce the trust is either very weak or non-existent. This right is only a “mere expectancy” — this is at a level lower than a “mere equity” which is enforceable in equity (¶13-210).
 - simplicity of operation. The trustee may make an annual distribution of trust income. In doing so, the trustee must ensure that the objects of the settlor’s intentions are benefited in the light of needs that may fluctuate from time to time.
 - tax advantages: income-splitting. The discretionary trust is a useful income-splitting device for tax purposes, although its advantage in this area is no longer so great with the introduction, from 1 July 1987, of the imputation system for taxing company dividends. Trust income attracts tax once only in the hands of the beneficiary, whereas there was double taxation of company income — in the company’s hands and then in the hands of shareholders as taxable dividends. Under the imputation system, provided dividends are paid from income taxed at the full company rate, they are tax free in the hands of shareholders.⁶⁵ Otherwise the shareholders pay tax on the dividends, but in any event tax is only paid once.
- Ownership of property by a discretionary trust also allows for capital gains tax-splitting which would be of special benefit to low-taxed beneficiaries.
- holding property. Holding property in the name of a discretionary trust may:
 - prevent accumulation of assets in one name, which may protect the pension entitlements of a beneficiary;

65. This is only true when the shareholder’s personal tax rate is less than or equal to the company tax rate. If the shareholder’s rate is greater than the company rate, then the shareholder has to pay some

additional tax. If the shareholder’s rate is less than the company rate, then fully franked dividends are better than tax free as there will be an excess tax credit.

- be useful for holding property that is rapidly increasing in value due to inflation, and
- provide protection from legal claims such as those in divorce.

Holding property in the name of a trust is no protection from bankruptcy proceedings: ¶13-670—¶13-690.

- winding up. The trustee has the option to terminate or to continue the trust: ¶9-980.

Disadvantages of the discretionary trust include:

- loss of absolute ownership. The trustee has the legal ownership, which prevails over the equitable ownership of the beneficiaries.
- loss of control. The trustee may make decisions which may not please the beneficiaries, such as distributing wealth to minors.
- accountability. A spouse or child may be able to challenge the decision of the trustee in court.

¶9-790 Two-dollar nominee company. In the modern business context the trustee is often a proprietary limited company, eg a \$2 nominee company. This means that the trustee's liability is limited to its share capital (\$2) but in all other respects it operates as if it were a natural person trustee. However, even though the trustee's liability is limited, in some circumstances the assets of the trust may be available or the trustee's directors may be personally liable. Corporations Law sec 197 provides that creditors can recover from the corporate trustee *and* its directors: ¶9-900. The trustee's liability is discussed further at ¶9-885.

¶9-800 Unit trusts. The unit trust is another extension of the private trust into the business world. The unit trust has been explained as:

"... one which derives income, often from the carrying on of a business, under a deed which contemplates 'capital' being represented by units, usually of equal size, where the number of units held determines the entitlement of the unit holder to annual distributions of net income and to his interest in the assets of the trust. The units issued by the trust may be beneficially owned by a discretionary trust or trusts."⁶⁶

Not so long ago unit trusts were primarily used to gather together investors to pool their (usually) small sums with a (usually corporate) trustee for the purposes of investment. In recent years:

"[the] importance of unit trusts has grown to such an extent that ... it is probably not an overstatement to say that unit trusts have in many respects

66. Betts, Buchanan and Baxt, *Corporate Trustees*, CCH Australia Limited, 1979, ¶203.

supplanted companies as the most common vehicle through which business is conducted in the non-public company area.”⁶⁷

This description refers to a unit trust operating as a trading trust and should not be taken to cloud the distinction between a publicly listed unit trust (raising funds from the public) and (as discussed here) a unit trust operating as a trading trust in the private business context. (Equity trusts, investing a pool of shareholders’ funds in the stock market, offering income and capital growth, run by a manager who selects the investments and monitors their performance on a frequent basis, have soared in recent years. The income of the beneficiaries is determined by the small sums or the units held in the trust.

A unit trust has the following advantages over a discretionary trust:

- transferability of units;
- fixed annual entitlements to income; and
- fixed entitlements to “capital” (the value of the units).⁶⁸

If the trustee of the unit trust is a company, the liability of the trustee will be limited (to the amount of the company’s share capital: ¶9-790).

A unit holder has a proprietary interest in each asset of the trust and can therefore lodge a caveat over land owned by the trust (¶3-280) — notwithstanding the possible duration of the trust, the extremely wide powers of management given to the trustee and the possibility that the trust might lose the whole or part of its capital through unprofitable trading or speculation.⁶⁹

One disadvantage of a unit trust is that unit holders (the beneficiaries) could be jointly and personally liable under trust law to indemnify the trust, through its liquidator, for any shortfall of assets on liquidation,⁷⁰ in the absence of a limitation of indemnity clause in the trust deed.

¶9-810 Trading trusts. Goodwill and assets of a business may be transferred to a trustee by the will of a deceased trader, or by transfer (*inter vivos*) by a business entrepreneur. The type of trust so used is normally a discretionary trust, and the business conducted by the trustee, for the trust and its beneficiaries, is called a trading trust.

One of the main benefits of a trading trust as the vehicle for carrying on a business was the taxation benefit. As noted at ¶9-780, before the introduction of the imputation system for taxing company dividends (in 1987), the *Income Tax Assessment Act* imposed “double” tax on companies

67. See further Walsh, MJ, “Unit Trusts” in Grbich, Munn, Reicher, *Modern Trusts and Taxation*, Butterworths, 1979, p 37, first published in (1976) 10 TIA 534. See further Stewart, R, *Unit trusts — legal relationships of trustee, manager, unitholders* (1988) 6 C & SLJ 269.

68. Betts, Buchanan and Baxt, *op cit*, ¶230.

69. *Costa & Duppe Properties Pty Ltd v Duppe* [1986] VR 90, noted (1986) 60 LIJ 46; (1987) 61 ALJ 147.

70. *JW Broomhead (Vic) Pty Ltd (in liq) v JW Broomhead Pty Ltd* [1985] VR 891; (1985) 3 ACLC 355; ¶9-890.

— tax on the company and tax on the dividends received by the shareholders. This contrasted unfavourably with a trust, where tax is imposed only on the trustee or the beneficiary but not both.⁷¹ The taxation statistics reflected the taxation advantage of trusts before dividend imputation, with a disproportionate rise in the creation of trusts in the 1970s. Now that imputation has abolished the double taxation of company dividends, trusts no longer have this taxation edge.

The other benefit of a trading trust as a business vehicle has to do with legal liability. As noted at ¶9-885 and ¶9-900, there is considerable potential for a trading trust to limit its liability to creditors, especially through the use of a \$2 company as trustee. In the words of Professor Ford:⁷²

“First, a creditor will not get payment out of trust assets unless the entity, in incurring the debt, was acting within powers given to it by its creators. In other words, the creditor is subject to the full rigours of the doctrine of *ultra vires* without the benefit of anything like s 20 of the *Companies Act 1961*.^[73]

Secondly, a creditor will not get payment out of the assets unless the organs of the entity (that is to say, trustees equated to directors) have avoided committing any breach of any of their duties to the entity. Even a breach of a duty unrelated to the creditor’s transaction could prejudice him. In other words the creditor can be affected by the internal affairs of the entity. There is nothing like the rule in *Royal British Bank v Turquand* ^[74] to protect him.

Thirdly, a creditor will not get payment out of the assets if the constitutive instrument (the trust instrument equated to the memorandum and articles of association) denies access by creditors to trust assets.”

¶9-820 Governing law. Each jurisdiction has a *Trustee Act*¹ in a similar form which consolidates the law relating to trustees. It sets out the position of the trustee, the authorised investments the trustee can put trust moneys into, and the trustee’s other powers, rights and liabilities. Beyond this, trusts are not covered by specific legislation — the Trustee Acts are not codes — and the rules of common law and equity govern their operation.

Some rights under a trust such as the rights and duties of the manager and the trustee are *contractual*, but because trusts originally came under the jurisdiction of the Court of Chancery — now the equity court — most rights under a trust were not enforced as contracts because contracts were only

71. *Income Tax Assessment Act 1936* (Cth) sec 97 (beneficiary); sec 98 (trustee).

72. Ford, HAJ, *Trading trusts and creditors’ rights* (1981) 13 MULR 1 at pp 1-2. See further Millhouse, AM, *Trading trusts* (1988) 18 QLSJ 443; Harrison, FL, *The trading trust* (1989) 19 QLSJ 19.

73. See now Corporations Law sec 124-125, noted at ¶9-490.

74. (1856) 6 E & B 327; 119 ER 886; ¶9-470.

1. *Trustee Act 1958* (Vic); *Trustee Act 1925* (NSW); *Trusts Act 1973* (Qld); *Trustee Act 1936* (SA); *Trustees Act 1962* (WA); *Trustee Act 1898* (Tas); 1957 (ACT); *Trustee Acts 1893 and 1907* (NT).

enforced by the common law courts. For example, the doctrine of privity of contract (¶6-260) does not apply to a trust, so that a manager or trustee can enforce the *equitable* rights of the beneficiaries under the trust.²

¶9-830 Establishment. Trusts are created *inter vivos* (between living persons or during life) or by will. To establish a trust a number of conditions must be satisfied: a deed of settlement satisfying the various certainty requirements has to be prepared, and executed by both settlor and trustee.

Express trust. In the creation of an express trust (¶9-755), the so-called “three certainties” requirements must be complied with, namely:

- (1) certainty that a binding trust is intended;
- (2) certainty in the identification of the trust property;
- (3) certainty as to the persons intended to benefit under the trust.

Discretionary trust. A discretionary trust (¶9-755) can be established in a variety of ways. A common arrangement is where a settlor transfers some property to a trustee (usually someone other than the settlor) on the condition that the income from the property be distributed each year among such of the beneficiaries, and in such proportions, as the trustee cares to choose. The trust deed may also stipulate that in the event of a lapse of appointment the income would belong to all the beneficiaries equally. The beneficiaries are usually defined widely, eg “children, grandchildren and other issue of (the settlor)”. With regard to the corpus or capital of the trust, the usual covenant is that it belongs to nobody until the “vesting day” — on which day the trustee would again use the large discretion to divide it among such beneficiaries and in such proportions as the trustee chooses. The “vesting day” would usually be a remote point in time, but it must not conflict with the rule against perpetuities or the statutory modification of that rule applicable to the particular trust.

— *Case example* —

In her will, the deceased gave discretionary power to her trustees to transfer property to a named charity for certain purposes. This bequest failed, was held void for uncertainty and the deceased was therefore held to have died intestate (see further ¶3-700). Under the rule against delegation of testamentary power, a settlor cannot leave it to another person (the trustee) to select beneficiaries or to make a transfer without infringing the requirement of certainty (refer to the “three certainties” above).

— *Lutheran Church of Australia South Australia District Incorporated v Farmers' Co-operative Executors and Trustees Ltd*³ —

2. *Rural and Agricultural Management Ltd v West Merchant Bank Ltd* (1995) 18 ACSR 793.

3. (1970) 121 CLR 628.

¶9-840 Formalities in the creation of trusts. Legislation based on the English *Statute of Frauds (1677)* (Imp) and the *Wills Act 1837* (Imp) imposes formal requirements for the creation of express trusts.

Land and interest in land. Legislation based on sec 7 of the English *Statute of Frauds 1677* is to the effect that a declaration of trust of real estate is unenforceable unless it is in writing and signed by the trust creator. The law⁴ provides:

- “(1) Subject to the provisions of this Act with respect to the creation of interests in land by parol:
- (a) no interest in land can be created or disposed of except by writing signed by the person creating or conveying the same, or by his agent thereunto lawfully authorised in writing, or by will, or by operation of law;
 - (b) a declaration of trust respecting any land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will;
 - (c) a disposition of an equitable interest or trust subsisting at the time of the disposition must be in writing signed by the person disposing of the same, or by his will, or by his agent thereunto lawfully authorised in writing.
- (2) This section does not affect the creation or operation of resulting, implied or constructive trusts.”

The following points should be noted in relation to these provisions:

1. Subsection (1)(b) applies to “land or any interest therein”. The section includes all trusts of land (including trusts of leasehold interests), but not trusts of personal property. An oral declaration of trust of a legal interest in personal property is therefore valid.
2. The realty characterisation is made at the time of the trust creation. Thus, if there is a purported oral trust of land which is then sold and converted into money, the determination of whether there is a valid trust is related back to the attempted trust creation — the subject matter here would be land.
3. Subsection (1)(b) is evidential only; non-compliance does not affect the validity of the trust. But where a declaration of trust also falls within subsec (1)(a) (as in most cases) or within subsec (1)(c) (any declaration of a trust of an equitable interest in real or personal property) the essential validity aspects of subsec (1)(a) and (c) would apply.
4. Subsection (1)(b) applies to the trust creator — not the trustee or an agent of the creator.

4. eg *Conveyancing Act 1919* (NSW) sec 23C; *Property Law Act 1958* (Vic) sec 53; *Property Law Act 1974* (Qld) sec 11; *Law of Property Act 1936* (SA) sec 29;

Property Law Act 1969 (WA) sec 34; *Conveyancing and Law of Property Act 1884* (Tas) sec 60(2); cf ¶3-220; ¶5-030; ¶13-047.

5. Subsection (1)(b) requires that the essential items of the trust be set out in writing (the nature of the trust, the trust property and its terms).
6. The writing need not create the trust; the only requirement is that the trust declaration be "manifested and proved". The evidential requirement may be satisfied after an oral declaration of trust.
7. The formality provisions will be ignored by the courts if not to do so would produce an unjust result or permit fraud.

Personalty. A declaration of trust over personal property need not be evidenced in writing unless the property is an existing equitable interest (in which case subsec (1)(c) probably applies).

¶9-860 Trustee companies. In addition to the principles of trust law, there is specific legislation in some jurisdictions to cover the activities of trustee companies.⁵ The Victorian Act, for example, names the ten trustee companies to which it applies. Services available from trustee companies include management of clients' affairs, executor, administrator and trustee functions, and mortgage financing. The Act sets out powers of trustee companies in relation to executor, administrator, trustee, receiver, commission chargeable and how calculated, and other such administrative matters. The legislation authorises a trustee company, unlike other legal personal representatives, to charge commission for acting as executor or administrator of a deceased estate (¶13-730).

The settlement is made when the settlor transfers to the trustee the initial settled property and the trustee records in the minutes the acceptance of the office of trustee. The deed must be submitted to the Stamps (Stamp Duty) Office for assessment for State stamp duty and payment of stamp duty.

¶9-870 Continuity of existence. Where property is vested in a trustee, whether a natural or corporate person, the death or disability of an individual beneficiary has no effect on the actual continuation of the trust. The trust deed may give the trustee the power to decide on re-allocation of the deceased beneficiary's share.

The death of the trustee is a different matter. If the trustee was the sole or last surviving trustee, the position of trustee becomes vacant. The trustee's legal representative — executor or administrator — has no power to take over as trustee unless (as is usually the case) specifically so named in the trust deed. But the continuation of the trust is not affected by the need to have a new trustee appointed. Appointment can be made by a surviving or continuing trustee, or by a personal representative of the last surviving trustee.⁶ If there is no person nominated in the trust to take over

5. *Trustee Companies Act 1984* (Vic); *1964* (NSW); *1968* (Qld); *1988* (SA); *1987* (WA); *1953* (Tas); *1947* (ACT); *Companies (Trustees and Personal Representatives) Act 1981* (NT).

6. See Trustee Acts of the various jurisdictions: Vic sec 41(1); NSW sec 6(4); Qld sec 12(1); SA sec 14(1); WA sec 7(1); Tas sec 13(1); ACT sec 8 (importing the NSW Act).

as trustee, and if there is no personal representative of the last surviving trustee willing to make an appointment, appointment of a new trustee can be made by the beneficiaries. If for any reason the beneficiaries cannot make the appointment, the court has jurisdiction to do so.⁷

¶9-880 Trustees' duties. Any person asked to act as a trustee — of a family trust or of a multi-million dollar superannuation fund⁸ — must bear in mind that centuries of equity law have placed upon trustees various well-established duties. Previously emphasising compliance with the intention of the settlor, these duties now revolve around maintenance of the economic well-being of the trust and the welfare of the beneficiaries.

- (1) *Duty to obey the terms of the trust.* The trustee must be familiar with and obey the terms of the trust. The trustee must take control of the trust property promptly, secure title over trust assets and protect documents of title.
- (2) *Duty to keep accounts and provide information.* The trustee must keep accounts and provide information to beneficiaries (or their representatives) as required, and, as beneficial owners of the trust property, beneficiaries have the right to inspect the accounts and the other trust documents. This follows from the trustee's fiduciary duty to keep the beneficiary informed.⁹
- (3) *Duty to administer the trust personally.* The trustee as a delegate, cannot further delegate responsibilities (subject to exceptions in favour of skilled agents such as bankers, solicitors, etc), as it is clearly established that the trustee must act in person. Because trustees must act personally,
 - all trustees must attend trustee meetings so that they can act personally and unanimously, and
 - trustees must not "fetter their discretion" (ie they must not restrict their future conduct). Equally, if appropriate, a trustee is under a duty to take advice.
- (4) *Duty of care.* The standard of care of the trustee to fulfill its duty of care (¶4-080) is that of the "ordinary prudent person" looking after the person's own affairs.
- (5) *Duty of loyalty.* The trustee's duty of loyalty is clear in the duty to avoid conflict of interest and to act exclusively for the benefit of the beneficiaries of the trust. In particular, the trustee is prohibited from deriving any direct or indirect personal profit or benefit from the office

7. See Trustee Acts: Vic sec 48; NSW sec 70; Qld sec 80; SA sec 36, 43; WA sec 77; Tas sec 32; ACT sec 8 (importing the NSW Act).

8. eg Lee, WA, *Modern portfolio theory and the investment of pension funds* in Finn, PD (ed), *Equity and Commercial*

Relationships, The Law Book Co Ltd, 1987, Ch 10; Maclean, D, *Superannuation fund trustees and conflicts of interest* (2000) 74 ALJ 47.

9. eg *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, noted (1993) 67 ALJ 703.

of trustee¹⁰ beyond reimbursement of out-of-pocket expenses and (if allowed in the trust deed) professional remuneration for a trustee such as a solicitor-trustee or an accountant-trustee. This is an aspect of the fiduciary duty owed by trustee to beneficiaries: ¶9-770.

- (6) *Duty of impartiality and fairness.* The trustee must not favour one beneficiary over another. For example, where personal property is left by a will to various beneficiaries to be used in succession, the trustee must preserve it for later beneficiaries by converting perishable or wasting assets into permanent and income-bearing investments.¹¹
- (7) *Duty to invest.* By legislation and under case law, the trustee is under a duty to invest the trust funds. In some jurisdictions, trustee legislation sets out a “legal list” of “authorised investments” including bank deposits, mortgages and blue chip shares,¹² which gives the trustee new freedoms, but which is drafted “in apparent recognition”¹³ of the judgment in the *Scargill case* (below) which imposed a duty to exercise the powers of a trustee in the best interests of all present and future beneficiaries. In other jurisdictions, the investment test of the trustee remains that of the “prudent person”.¹⁴

Trustees are subject to the overriding duty to do the best they can for the beneficiaries. This is the trustee’s duty of undivided loyalty. In particular, modern trustees are entitled to be judged by the standards of portfolio theory or maximised diversification, which emphasises the risk level of the entire portfolio.

If a trustee is sued for breach of trust, the court may take into account the trustee’s investment strategy.¹⁵ This includes the nature and the purpose of the trust; whether the trustee had regard to the matters set out in the legislation; whether the trust investments have been made in accordance with the duty of the trustee; and the extent to which the trustee acted on the independent and impartial advice of a competent person.

— Case examples —

The Arthur Scargill case. The UK mineworkers pension fund was administered by 10 trustees — five appointed by the National Coal Board, and five appointed by the mineworkers’ union. The five union trustees refused to

10. ie the rule in *Keech v Sandford* (1726) King 61; 25 ER 223.

11. *Howe v Lord Dartmouth* (1802) 7 Ves 137; 32 ER 56.

12. eg *Trustee Act 1925* (NSW) sec 14-14E; *Trustee Acts 1893 and 1907* (NT) sec 4.

13. *Jones v AMP Perpetual Trustee Company NZ Ltd* [1994] 1 NZLR 690 at p 706.

14. eg *Trustee Act 1958* (Vic) sec 6; 1936 (SA) sec 7; discussed by McDermott, P,

Trustee investment law reform (1996) 70 ALJ 801: “A purchase of shares by a WA trustee would be an authorised investment”; however, “if a Qld trustee made a similar investment, that would be a breach of trust.”

15. This test, which is spelled out in the new legislation jurisdictions (Vic, SA and the NT), clarifies the case law applying in the other jurisdictions.

approve a plan for the fund to invest overseas (because it was union policy to invest onshore) and to invest in energy industries that were in competition with coal (namely oil and gas). The union trustees were held to be in breach of their duty to the beneficiaries (many of whom were retired) or their dependants (who had no further financial interest in the welfare of the coal industry). The trusts of pension funds are subject to the same rules as other trusts, and trustees cannot refuse for social or political reasons to make an investment if that investment would be more financially beneficial to the beneficiaries.

*Cowan v Scargill*¹⁶ —

The Nestle Trust. On his death in 1922, the testator left an estate of £54,000 to be administered by D as trustee of his will. By 1986, the fund had grown to £269,000. P, the granddaughter, claimed that if the fund had been properly managed, it would have been worth over £1m. On another calculation, it could have been worth £2.6m. P failed to prove that the trustee's investment policy had caused her "loss".¹⁷ There was evidence that the trustee had not diversified the investments beyond the original fixed interest and bank and insurance shares, and that there were no regular reviews of the fund until 1959. However, the fund as a low risk portfolio had survived the Depression and World War II, had paid an annuity to the widow until her death in 1960, had made some tax-effective investments and had returned steady income and capital growth since 1922.

*Nestle v National Westminster Bank plc*¹⁸ —

The *Scargill* case confirmed that the standard of care of a trustee is "to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide".¹⁹

In addition, the court can authorise any investment not provided for by the trust deed or by the legislation under its "expediency" jurisdiction.²⁰

- (8) *Duty to pay only if authorised.* The trustee can pay money only if authorised by the trust. A trustee who commits breach of trust must account for and restore to the trust the amount lost. Restitution is absolute, and is different from an award of common law damages because it does not have a requirement of causation. For example, a solicitor who released mortgage funds to his client before being authorised by the mortgagee was ordered to make restitution to the mortgagee for breach of trust.²¹

16. [1984] 2 All ER 750.

17. In this context, a "loss" is incurred if the trust fund makes a gain that is less than would have been made by a prudent trustee.

18. [1993] 1 WLR 1260; [1994] 1 All ER 118, noted (1992) 66 ALJ 760.

19. *Re Whiteley* (1886) 33 ChD 347 at p 355.

20. eg *Trustee Act 1925* (NSW) sec 81; *1958* (Vic) sec 63; *1936* (SA) sec 59B; *Trustee Acts 1893 and 1907* (NT) sec 50A.

21. *Target Holdings Ltd v Redfern* [1994] 2 All ER 337, noted eg (1994) 110 LQR 328 (Heydon).

- (9) *Duty to pay the correct beneficiaries.* The trustee is under a duty to recover overpayment to any beneficiary. An underpaid beneficiary can sue the trustee for breach of trust.

Case law applies a standard of care to professional trustees which is higher than that applying to the ordinary prudent business person.²²

¶9-885 Liabilities of the trustee. Administration of a trust may involve making contracts, owning property, incurring liability to tax, and the committing of tortious acts or omissions by the trustee or persons connected with the trust. The trustee is normally personally liable for these and other liabilities associated with the trust on the basis that a trust is not a separate legal entity (being no more than a collection of duties, disabilities, rights and powers) and is not a legal person which can sue and be sued in its own name.

A trustee in breach of its fiduciary duty must place the trust estate in the same position as it would have been in if no breach had been committed. The test of causation for the equitable remedy of compensation for breach of fiduciary duty is not the common law test of causation, foreseeability and remoteness.²³

Certainly a trustee may exclude legal liability by express stipulation that he is acting as trustee and does not accept personal liability²⁴ (eg contracting “as trustee and not otherwise”). The personal liability of a trustee may also be deflected by the use of a limited liability company as trustee for the trust.

A trustee may face criminal liability, for example for theft (¶2-320—¶2-340).

Constructive trust: recipient liability. A person who receives or deals with trust property which the person knows to be in breach of trust will be held to be a constructive trustee of the property.

The liability of a constructive trustee for breach of trust was set out in the *Brunei case* as follows:

- Actual dishonesty — this is the objective standard of not acting as an honest person would. Taking risks is not necessarily dishonest.
- An honest but negligent third person — such as an adviser or banker — who assists in a breach of trust could also be liable for default to the beneficiaries of the trust.
- A dishonest third person who acts for a dishonest trustee could also be liable to the beneficiaries.

22. *Australian Securities Commission v AS Nominees Ltd* (1995) 133 ALR 1, per Finn J at p 14.

23. eg Leeming, M, *Causation and compensation for breach of fiduciary duty* (1966) 70 ALJ 537.

24. eg *Muir v City of Glasgow Bank* (1879) 4 App Cas 337.

Shelter behind the two-dollar nominee company. Incorporation of the trustee as a limited liability company (with a paid-up capital of \$2 (see ¶9-790)) provides shelter to the trustee in the form of the company against which the creditors must go for recourse. The use of such a company, however, does not necessarily block the creditors, as in reality the creditors may have taken as added security a personal guarantee signed by the trustee (¶13-360), and/or the creditors may be able to take action against the directors of the trustee company under the Corporations Law if misfeasance and dereliction of duty can be shown. However, the rights of beneficiaries against the directors are not established.

— *Case example* —

The Pancake Kitchen

When partner Heath (D) purchased partnership property without the consent of partner Hurley (P), the resulting legal proceedings gave rise to important questions of company law, trust law, and the law relating to corporate trustees. The reasons for the decision in favour of P are explored below.

BGH Nominees Pty Ltd was the corporate trustee of the BGH Trust which carried on business as the Pancake Kitchen in Adelaide. Its shareholders and directors were Noel J Hurley Pty Ltd and Robert Heath Pty Ltd; the beneficiaries of the trust were the same two companies. D incorporated another company for the purchase of the business premises arguably with the consent of P. However, P disputed consent and successfully sought a declaration that the property purchased by D was held on trust for the business.

*Case No 1.*²⁵ D argued that P lacked the necessary standing to sue as shareholder in his own name to redress an alleged wrong against the company, and that action must be brought in the name of the company under the rule in *Foss v Harbottle* (now replaced by a statutory derivative action: ¶9-470). D argued further that standing should be denied to P because of the existence of an alternative remedy available to the trust beneficiaries, not against the corporate trustee but against the directors of the corporate trustee for breach of trust.

The right of the beneficiaries to sue the directors of the corporate trustee was considered by White J, stated to be “not clear” and the existence of this alternative remedy not accepted. He quoted Betts, Buchanan and Baxt, *Corporate Trustees*²⁶ at length, approved it and confirmed the points there raised that:

- directors of a company stand in a fiduciary relationship to the company, not the shareholders (¶9-470).

25. *Hurley v BGH Nominees Pty Ltd* (1982) 31 SASR 250; (1982) 1 ACLC 387; discussed by Inglis, MW, *Personal liability of directors of corporate trustees of trading trusts and superannuation funds* (1984) 1 C & SLJ 48; Wishart, DA, *A conservative response to Hurley's case* (1986) 4 C & SLJ 4; Berns, SS, *The application of*

associative theory to Hurley's cases — a response to David Wishart (1986) 4 C & SLJ 189.

26. Betts, RW, Buchanan, RF and Baxt, R, *Corporate Trustees — Disclosure, Taxation and the Liability of Officers*, CCH Australia Limited, 1979, esp ¶328, ¶330, which the judge quoted almost in full.

- directors of a corporate trustee presumably do not owe a fiduciary duty to trust beneficiaries who are not shareholders of that company.
- a trustee (including a corporate trustee) can seek indemnity from the trust fund (¶9-890), yet beneficiaries who are not shareholders have no legal rights against the directors.
- the question to be answered as raised by Betts et al at ¶330 is: “Will the courts in such a case set aside the corporate veil and make the directors of the company personally responsible for breaches of trust? In our view the courts will be inclined to do this. ... But to do this will require a marked departure from current thinking and practice by the courts.” As the judge stated, “[w]hatever the future developments of the law may be, it is not clear that the beneficiaries under a trust deed have a cause of action against [the directors, rather than the company]”.

*Case No 2.*²⁷ Standing having been approved, the court upheld P’s case on the basis that the breach of the fiduciary responsibility of Heath, as director of the company, to take into account the interests of the shareholders in BGH Nominees Pty Ltd was sufficient to support the action of the shareholders, and the issue of intervention by the beneficiaries of the trust against the directors of the corporate trustee did not require further exploration.

¶9-890 Rights of the trustee. The rights of the trustee are based on statute, case law and the terms of the trust instrument. The trustee’s rights include:

- (1) *Right to remuneration.* The trustee is not entitled to remuneration (or commission or fees) for services unless allowed by statute,²⁸ the beneficiaries, the trust instrument or the court.
- (2) *Right to indemnity.* The trustee who commits a breach of trust at the request of or with the consent of the beneficiary is entitled to indemnity (or contribution) from:
 - the assets of the trust;
 - a beneficiary who is of full age and legal capacity (*sui juris*) who has agreed to the breach of trust;²⁹
 - a co-trustee.

The proceeds of the trustee’s right to indemnity are only available to creditors of the trust (the narrow view), not the trustee’s creditors

27. *Hurley v BGH Nominees Pty Ltd (No 2)* (1984) 37 SASR 499; (1984) 2 ACLC 497, noted (1985) 59 ALJ 46.

28. eg *Trustee Act 1962* (WA) sec 98; *Succession Act 1981* (Qld) sec 68.

29. See, eg, *Trustee Act 1925* (NSW) sec 86; 1958 (Vic) sec 68; 1973 (Qld) sec 77.

generally (the broad view).³⁰ This is based on the principle that assets of the trust can only be used for the payment of trust liabilities, so a non-trust creditor could not access the trustee's right of indemnity.

- (3) *Right to reimbursement of trust expenses.* The trustee can be reimbursed trust expenses incurred in the proper exercise of the trustee's powers. Trust expenses include payments to agents, taxes, litigation costs incurred in the proper exercise of the trustee's powers, and tortious liabilities incurred in the ordinary management of the trust.

The trustee is entitled to be reimbursed from the trust estate for expenses properly incurred on behalf of the trust.³¹ The trustee need not wait to be sued before seeking indemnity, and is considered as having a first charge (¶13-048) or lien (¶13-280) on the trust estate for the right of indemnity or reimbursement.³²

— Case examples —

Trustee, the legal owner of partly paid shares in a bank, held the shares in trust for beneficiary. As legal owner, trustee had to pay calls on the shares. Trustee was entitled to indemnity from beneficiary for these calls. The rule in *Hardoon v Belilios* says that if the trust estate does not hold sufficient funds to meet the claims on it, a trustee of a fixed trust may be entitled to a right of indemnity from a beneficiary personally where the beneficiary is of full legal capacity (*sui juris*) and "absolutely entitled". Such action by the trustee is within the scope of the trust and for the benefit of the beneficiaries. The rule is not based on the consent of the beneficiary, but is based on the principle that the beneficiary who has the benefit of the trust should also bear the burden.

*Hardoon v Belilios*³³

A building business was established as a unit trust under the name of "The Broomhead Victoria Trust". The corporate trustee of the group was JWB (Vic) Pty Ltd, and the unit holders were (1) JWB Pty Ltd (42%); (2) B Pty Ltd (10%); (3) A Pty Ltd (24%) and (4) Lynette and Graham Wood (24%). Incurring financial problems, the business went into liquidation, and action was taken in the corporate trustee's name by its liquidator to seek indemnity for the deficiency of \$65,000—\$70,000 from the unit holder beneficiaries. The liquidator's action was essentially successful, the court holding that:

- (1) JWB Pty Ltd and (2) B Pty Ltd were personally liable to the extent of 42% and 10% respectively of the amount claimed.

30. The broad view is supported, eg, by *Re Enhill Pty Ltd* [1983] 1 VR 561, which is now described as obviously wrong by Meagher RP and Gummow WMC, *Jacobs' Law of Trusts in Australia*, Sydney, Butterworths, 6th ed, 1996, para 2114.

31. Trustee Acts: Vic sec 36(2); NSW sec 59(4); Qld sec 72; SA sec 35(2); WA sec 71; Tas sec 27(2); ACT sec 8.

32. See Betts, Buchanan and Baxt, *Corporate Trustees, op cit*, ¶103, ¶106.

33. [1901] AC 118 at pp 123-124. If the beneficiaries are of little substance, the trustee may become personally liable to meet claims. See further Brabazon, CLJ, *Trusts and personal liabilities* (1985) 15 QLSJ 173; Hardingham, IJ, *Trading trusts — rights of indemnity and creditors' rights* (1986) 60 LIJ 240.

- (3) A Pty Ltd, being insolvent, could not pay its 24%.
- (4) Because Lynette Wood had not known of her joint interest in the Woods' 24% unit holding, and because she had validly disclaimed her interest upon learning of it, Graham Wood became absolutely entitled to the 24% unit holding and therefore liable to the extent of 24%.

The liquidator's claim for a personal indemnity from the unit holder beneficiaries was successful. *McGarvie J* decided that the rule in *Hardoon v Belilios* (above) giving a right of personal indemnity from one beneficiary extends to a case "where there is more than one beneficiary and all of them are *sui juris* and entitled to the same interest [ie a vested absolute interest] as absolute owners between them". All beneficiaries do not have to be *sui juris* before a personal right of indemnity can exist against those who are.³⁴

A beneficiary with less than an absolute interest may also be liable to the trustee if that beneficiary has requested the trustee to assume office or to incur what would otherwise be an unauthorised liability.

*JW Broomhead (Vic) Pty Ltd (in liq) v
JW Broomhead Pty Ltd*³⁵—

This trustee's right to indemnity is basically only applicable in a fixed trust or in a unit trust. *Hardoon v Belilios* recognised that a trustee has no right against beneficiaries if the beneficiaries have a limited instead of an absolute interest (such as an interest held on trust for tenants for life, or for infants, or upon special trusts limiting the right to indemnity). Emphasising this last point, the personal liability of beneficiaries to the trustee can be excluded by express provision in the trust deed. In the case of a discretionary trust it is not known until the (usually) annual exercise of the trustee's discretion which objects or which beneficiaries are entitled to share in the trust assets.

- (4) *Right to apply to the court for advice* in cases involving doubt or uncertainty.
- (5) *Right to a discharge* — after completion of the trusteeship, submission of final accounts of the beneficiaries, etc.
- (6) *Right to pay trust moneys or securities into court*, for example in the event of disputes about beneficial ownership of trust property.

¶9-900 Creditors' access to trust assets. Creditors may have access to trust assets, but such a right is by no means automatic and is subject to limitations and exceptions of various kinds. The relevant propositions on this issue are set out by Ford and Lee:³⁶

1. If there is a stipulation that the trustee shall not be personally liable,

34. eg Ford, HAJ and Hardingham, IJ, "Trading trusts: rights and liabilities of beneficiaries" in Finn, PD, (ed) *Equity and Commercial Relationships*, 1987, pp 80-82.

35. [1985] VR 891 at p 936; (1985) 3 ACLC 355 at p 393.

36. Ford, HAJ, *Trading trusts and creditors' rights* (1981) 13 MULR 1.

persons contracting with the trustee may agree to look only to the trust property for payment.

2. The trustee is ordinarily liable personally for liabilities associated with the trust (§9-885).
3. The trustee has the right to recoupment or exoneration out of the trust property or from the beneficiaries (§9-890) but not from the settlor or from the objects of a discretionary trust.
4. The trustee's right to recoupment or exoneration is, in general, available in respect of liabilities not improperly incurred (such as expenses properly incurred in carrying on a business as a trading trust).
5. If the trustee is in breach of trust for which the trustee is liable to compensate, the trustee's right to recoupment or exoneration is denied or reduced because of the default.
6. A trust creditor may have the right to satisfaction directly out of trust property by right of subrogation. Where a trustee has a right to be indemnified out of the trust estate for liabilities incurred in the course of the administration, any outside creditor who has sued the trustee, and obtained judgment, will have the right to repayment direct from the trust estate or the trust assets.³⁷

This is called the creditor's right of subrogation — it is the right of the creditor to stand in the shoes of the trustee and to exercise the rights of the trustee.³⁸ Of course if the trustee has exceeded those rights, the trustee has no recourse against the trust fund; where the trustee has engaged in a personal frolic or has exceeded the trustee's powers there will be no right of subrogation and the trustee will be personally liable to the creditors. The creditors' rights will be no higher than those of the trustee. If the trustee is in default in some way, the amount due from the trust estate to the creditor will be reduced and the shortfall must be made up by the trustee personally.³⁹

This situation was corrected by 1985 company law amendments inserting the forebear of sec 197 in the case of corporate trustees. To ameliorate the consequences for creditors where there is no access to trust funds to meet liabilities incurred by a corporate trustee, sec 197 places joint and several personal liability (as with partners: §10-250) on a director of a company (except an "innocent" director) which is a trustee and which is acting in that capacity where the company incurs a debt in respect of which it is not entitled to be indemnified out of the assets of the trust.

§9-905 Powers of the trustee. Like a receiver/manager (§13-555), a trustee normally has extensive powers of management, administration,

37. *In re Raybould* [1900] 1 Ch 199; Grbich, Munn, Reicher, *op cit*, p 268; *In re Blundell* (1886) 40 ChD 370 at pp 376-377.

38. Compare subrogation in insurance law §17-920.

39. *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319.

protection and investment of the trust property and funds. The trustee has the discretion on whether (and if so how) these powers will be exercised. These powers, conferred by the trust instrument (expressly and by implication), by the various Trustee Acts, and by the court include:

- power to invest⁴⁰ — most but not all⁴¹ jurisdictions limit trustees to “authorised trustee investments” (¶9-880);
- power of sale;
- power to mortgage;
- power to insure;
- power to carry on a business;
- power to repair and improve property;
- power to lease;
- power of advancement;
- power of maintenance;
- power to appropriate trust assets in full or partial satisfaction of a beneficiary’s interest in those assets;
- power to issue receipts for payment made to the trust estate;
- power to compound liabilities owing to the trust;
- power to deposit trust documents for safe custody;
- power to call for an audit;
- power to employ agents;
- power to be both plaintiff and defendant in the one action.⁴²

¶9-910 Control by trustee. The complexity of a trust is even further complicated by the search by the principal entrepreneur for effective control. A trustee (whether a person or a corporate trustee) must maintain the fiduciary relationship with the beneficiaries of the trust, which means that a duty of good faith which is owed to the beneficiaries must always be maintained. Conduct less than this will mean breach of trust actionable by the beneficiaries. Such matters as payment by the trustee to the wrong person, improper sale of authorised investments, and investment in unauthorised investments are instances of this conduct.

40. See further, Lanyon, E, *Derivatives and modern portfolio theory: the trustee’s duty of investment* (1995) 6 JBFLP 58; Nicholls, Lord, *Trustees and their broader community: where duty, morality and ethics converge* (1996) 70 ALJ 205; McDermott, P, *Trustee investment law reform* (1996) 70 ALJ 801 at p 803.

41. eg *Trustee and Trustee Companies Amendment Act 1995* (Vic); *Trustee Act 1936* (SA) sec 6.

42. eg *Trustees Act 1962* (WA) sec 57; *Trusts Act 1973* (Qld) sec 59; *Preparation of trust deeds* (1989) 11 LSB (SA) 15.

Beneficiaries are not entitled to direct the trustee in the exercise of the trustee's powers and discretions, even if the beneficiaries are together absolutely entitled to the trust property, even though it is the duty of a trustee-shareholder to use the voting power in the interests of the beneficiaries. The trustee is the legal owner of the trust property, and can exercise its powers and discretions without consulting the beneficiaries.

¶9-930 Control by beneficiaries. The trustee is under a personal obligation to hold and to deal with the trust property for the beneficiaries or objects of the trust. This obligation is enforceable by the beneficiaries, whose rights include:

- (1) The right to inspect trust documents and to receive accounts of the trust: "the trustee is liable to account to the person, or group of persons for whose benefit he holds the trust property, and, that being so, the trustee is obliged not only to keep proper accounts and allow a [beneficiary] to inspect them, but he must also, on demand, give a [beneficiary] information and explanations as to the investment of, and dealing with, the trust property".⁴³
- (2) The right to compel performance of the trust, for example by applying to the court to remove a trustee who refuses to act in accordance with the trust.

The exercise of a trustee's discretion may be challenged by the beneficiaries if:⁴⁴

- not exercised in good faith;
 - not exercised on real and genuine considerations;
 - not exercised in accordance with the purposes for which it was conferred; and
 - where the trustee has disclosed the reasons for the exercise of the discretion, the reasons are not sound.
- (3) The right to apply to the court for an injunction to restrain actual or potential breach of trust.
 - (4) The right to apply to the court for advice on questions of interpretation and administration, (which includes the right to apply to the court to remove a trustee who refuses to act in accordance with the trust).
 - (5) The right to end the trust:
 - *fixed trust*. Under the rule in *Saunders v Vautier*,⁴⁵ the beneficiaries can end the trust by directing the trustee to transfer the trust

43. *Spellson v George* (1987) 11 NSWLR 300 at pp 315-316.

44. *Rapa v Patience*, Supreme Court of NSW, 1985, unreported, noted (1985) ACL 35.388, cited in *Chammas v Harwood*

Nominees Pty Ltd (1993) 7 ANZ Insurance Cases ¶61-175 at p 77,999; noted (1995) 69 ALJ 412.

45. (1841) Beav 115; 49 ER 282.

property to them if all beneficiaries agree, are of full age and capacity (*sui juris*) and are absolutely entitled to the trust property.

- *discretionary trust*. Instead of the clearly defined beneficiaries of the fixed trust, there is a class of persons (objects) defined in wide terms. It has been suggested that the group interest needed to give effect to the rule in *Saunders v Vautier* may not be clearly present because of the possible dispersion of the objects of the trust.⁴⁶ The better view, however, is to the contrary, giving the beneficiaries the right at least to end the trust.⁴⁷

Beneficiaries cannot direct the trustee in the exercise of the trustee's discretion, but they can vote to end the trust.

- (6) the right to bring a personal claim against a third person to recover amounts overpaid or wrongly paid by the trustee.
- (7) the right to bring a proprietary remedy to "trace" or to "follow" trust property into the hands of the recipient even if the property (such as money) has been mixed with other property.

¶9-940 Formalities/adherence to specific dates. Beyond the matters just noted, trust administration raises considerably fewer formalities than those faced by directors and officers of a company. The trust deed will set out the powers and liabilities of the trustee in quite wide terms. Under the heading "Income" the deed will usually state that the trustee "may" apply so much to a beneficiary "as the trustee thinks fit", etc. When it is said that adherence to the trust deed is the trustee's main responsibility, the formalities are not more than this. The necessary requirements are clearly set out in the trust deed, or are clear in equity law, namely, to allocate trust income to the named beneficiaries by the date prescribed in the trust deed.

¶9-950 Admission of new investor/participator. The trust deed will be the determining factor on the question of the admissibility of a new investor/participator into the structure. Normally a trustee will be empowered to apply trust moneys and to deal with investments and property constituting the trust fund as the trustee thinks fit as if the trustee were the absolute owner. The trustee has the power to borrow for the trust, to lend trust funds and to disperse the fund according to the trust deed. To this extent, there is flexibility in the hands of the trustee to involve other persons in the trust structure.

¶9-960 Alteration of a trust. The position regarding the possibility of making changes to a trust is as follows.

46. *Gartside v IRC* [1968] AC 553 at pp 605-606; *Sainsbury v IRC* [1970] Ch 712 at p 725.

47. *In re Smith* [1928] Ch 915; *Jacobs, op cit*, p 649.

Alteration of terms of a trust by trust parties. Unless a specific provision in the trust instrument allows the trust parties to change its terms,⁴⁸ the trust, in its original form, is binding once it has been constituted and accepted. At this stage the trustee is under a duty to obey the directions in the trust settlement — this especially applies to such matters as:

- (a) the nomination of beneficiaries,
- (b) investments, and
- (c) administration of the trust.

Generally, this means that—

- the trust creator is powerless to alter the terms of the trust, eg to remove a beneficiary, add a new beneficiary, impose new directions as to investment;
- the trustee likewise has no power to vary the trust: it is the trustee's duty to adhere strictly to the terms of the trust;
- to some extent the beneficiaries can alter the trust: provided there is no restriction on alienation they can assign their interests; in addition they can disclaim or surrender their interests.

Agreement of trust parties to alter trust. Where all the trust parties — settlor, trustee and all beneficiaries — unanimously agree to a change, it is difficult to imagine who could complain of the alteration. Any competent beneficiary who consents to such a change would be estopped from complaining about the execution of the altered trust. But a trustee could only be assured of not being liable to a breach of trust action if the beneficiaries, in giving their consent, fully understood the nature of their consent. In practice a trustee would want to obtain a release from all the beneficiaries.

Where possible beneficiaries are unborn, presently unascertained, or minors, a settlor and the trustee and other competent beneficiaries could not sanction the trust alteration.

Express power to modify trust terms. Most trusts today contain special provisions reserving a power to vary trust terms — this power may be reserved to the settlor, the trustee or even a beneficiary. It can be expected that a court would construe such a power most strictly. For example, without a special provision it would be unreasonable to suppose that such a power is not a personal one, that is, it could not be transferred to another person.

Approval of court to alter a private trust. The courts, in their inherent equity jurisdiction, have long had the power to approve alterations of the terms of express private trusts. However, the actual exercise of this inherent jurisdiction was most limited — the only permitted changes relate to the management and administration of the trust; certainly the inherent jurisdiction would not

48. eg Christie, M, *Amending discretionary trust deeds*, LSJ, Vol 30, No 1, p 71 (February 1992).

allow new beneficiaries to be added to alter the interests of existing beneficiaries. In general terms a trust alteration will be approved where—

- it is necessary to salvage trust property, for example, effect necessary repairs;
- there is an emergency relating to the administration or management of trust property;
- it is necessary to protect the interest of an infant beneficiary, for example, sell real estate which is falling in value and convert the proceeds into another investment;
- it is necessary to provide funds for the maintenance or advancement of children.

¶9-970 Ability to sell entire business interest. Trust assets can be sold by the trustee. A power of sale is given by the *Trustee Act* and is also usually to be found in trust deeds:

“... To hold use *purchase* construct demolish maintain repair renovate reconstruct develop improve subdivide exploit *transfer convey* surrender let lease exchange take and grant options or rights in alienate mortgage charge pledge reconvey release or discharge or otherwise deal with *any real or personal property*.” (italics added).

Unless there were this express authority contained in the statute or the deed, a trustee would have no power of sale because, after all, the trustee's duty is to preserve the trust property for the benefit of the beneficiaries.

¶9-980 Winding up trusts. Basically there are three main options, which are not necessarily mutually exclusive, for the winding up of a trust:

- (1) Distribution of trust assets to beneficiaries in kind or by the distribution of cash if authorised expressly or by inference by the terms of the trust instrument. Such terms include discretionary trusts over the trust estate, powers of appointment, powers to accelerate vesting, and powers of maintenance or advancement.
- (2) Release or variation of the trust obligations, either by the trustees, or the beneficiaries, or by the court under statutory powers to vary trusts. Trust obligations can be brought to an end by release by the trustee of the trust obligations, variation of the beneficiaries' interests and by the assignment of beneficiaries' rights.
- (3) Sale or disposition of the trust property or business (such as by appointment of the property to the objects of a discretionary trust) to some other entity.

In addition, if the trust is administered by a \$2 trustee company, further formalities are presented by the need to wind up the company according to the provisions of the Corporations Law, usually after the winding up of the trust itself.

FRANCHISE

Nature of structure	¶9-985
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Cessation of business	¶9-997

¶9-985 Nature of structure. Franchising is a marketing concept for the distribution of goods and services. A franchise is a contract where expertise, knowledge, method of operation and/or a trademark are granted by a franchisor to a franchisee for a period of time.⁴⁹ The franchisee agrees in return to sell the products or services under the control and the name of the franchisor.

The Franchising Code provides this formal definition of a franchise agreement:

“(1) A **franchise agreement** is an agreement:

- (a) that takes the form, in whole or part, of any of the following:
 - (i) a written agreement;
 - (ii) an oral agreement;
 - (iii) an implied agreement; and
- (b) in which a person (*the franchisor*) grants to another person (*the franchisee*) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor; and
- (c) under which the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol:
 - (i) owned, used or licensed by the franchisor or an associate of the franchisor; or
 - (ii) specified by the franchisor or an associate of the franchisor; and
- (d) under which, before starting business or continuing the business, the franchisee must pay or agree to pay to the franchisor or an associate of the franchisor an amount including, for example:
 - (i) an initial capital investment fee; or
 - (ii) a payment for goods or services; or

49. See generally, Williamson, G, *Franchising in Australia*, Allen & Unwin, 1999; Centre for Franchise Studies, UNSW.

- (iii) a fee based on a percentage of gross or net income whether or not called a royalty or franchise service fee; or
 - (iv) a training fee or training school fee;
- but excluding:
- (v) payment for goods or services at or below their wholesale price; or
 - (vi) repayment by the franchisee of a loan from the franchisor; or
 - (vii) payment for the wholesale price of goods taken on consignment; or
 - (viii) payment of market value for purchase or lease of real property, fixtures, equipment or supplies needed to start business or to continue business under the franchise agreement.”

Franchises are of four types:⁵⁰

- (1) A *product and tradename franchise* — where the franchisee acts as an independent distributor for a particular product, such as petrol or cars.
- (2) A *processing or manufacturing franchise* — where the franchisor provides an essential ingredient or know-how to a processor or manufacturer, as in the soft drink industry.
- (3) The most common franchise is the *system or business format franchise* — where a franchisor develops a manner of doing business and permits the franchisee to use that system in a controlled way in the operation of the franchisee’s independently owned business such as fast food outlets, laundries, dry cleaners and motels.

— *Example — system or business format franchise* —————

A fast food franchise might cover the following key items:

- The term of a franchise is normally [...] years.
- The franchisor selects all restaurant sites and either owns or leases the land and/or buildings. The franchisee leases the restaurant from the franchisor in a lease agreement which is conjoined to the franchise agreement.
- Franchisees pay rental (a fixed base rent or a percentage of gross sales, depending upon the land and construction cost of the restaurant) and service (royalty) fees to the franchisor.
- The franchisor’s once-only franchise fee is [...] per restaurant.
- Equipment and internal fittings for the restaurant are purchased by the franchisee and must be maintained, repaired and replaced, if necessary, by the franchisee.
- The minimum amount of working capital (in addition to the franchise fee and security deposit) presently required is about [...] for staff training, salaries, provision of trading stock, living expenses whilst training and other normal start-up expenses.

50. Compare Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs* (The

Swanson Report), Canberra, AGPS, 1976, p 36.

Selection criteria for franchisees include personal qualities, business acumen, employment or work experience and financial status.⁵¹

The founder of business format franchising is accepted as Ray Kroc, who acquired the rights to the McDonald's hamburger business from Dick and Mac McDonald in the 1950s.⁵²

- (4) *Co-operatives* (§9-270) are another type of franchise, although the Franchising Code (1998) does provide that the relationship between the members of a co-operative does not in itself constitute a franchise agreement (clause 4(3)).

Franchising: advantages. Franchisees are reported to have more than twice the chance of survival than a non-franchised business, due to the following benefits which franchising provides to the franchisee:⁵³

- Access to a business system developed under the franchisor's marketing, business and technical plan which has been tried, tested and refined over time;
- A track record of the franchise to enable assessment of its prospects;
- Small entrepreneurs can compete with national and international firms;
- Franchisees can benefit from an existing and successful name and reputation and hence have less chance of a business failure;
- The franchisor provides management support with ongoing business, training and technical assistance;
- Participation by the franchisee in collective or group marketing and advertising;
- A greater willingness by financial institutions to provide finance (if required) to purchase a franchise.

Franchising: disadvantages. On the other hand, the franchisee faces certain risks and disadvantages, such as:

- being locked into a binding franchise agreement with control by the franchisor (§9-992);
- business downturn;
- misrepresentation by the franchisor;
- inadequate assistance from the franchisor; and
- uncertainties at the end of the franchise (§9-997).

51. See, for example, McDonald's Australia, "Some key elements of McDonald's franchising", quoted by Burchett J in *Carr v McDonald's Australia Ltd* (1994) 63 FCR 358 at p 362.

52. eg, Love, JF, *McDonald's: Behind the Arches*, Bantam Books, New York, 1986.

53. Phillips, R, *Purchasing a franchise* (1995) 69 LJ 670.

¶9-986 Governing law. Franchises are governed by sections of many Acts, the common law principles of contract, fiduciaries, etc and, as from 1998, the Franchising Code of Conduct.⁵⁴

Franchises are governed by many sections of the *Trade Practices Act 1974* (Cth) including:

- sec 45(2)(a)(ii), 45(2)(b)(ii) (anti-competitive agreements: ¶8-050).

For example, the ACCC was concerned that proposed multiple site franchising in the petrol industry — where one franchisee would operate many service stations — might result in a substantial increase in concentration which might have anti-competitive potential.⁵⁵

- sec 47 (exclusive dealing: ¶8-360);
- sec 51AA-51AC (unconscionability: ¶5-755 — ¶5-756);
- sec 52 (misleading or deceptive conduct (¶7-250ff), as illustrated by *Crawford v Parish*, set out at ¶5-705).

At common law, franchise agreements are not regarded as being in restraint of trade (¶5-840) because the franchisee has voluntarily entered the agreement restricting its liberty.

— *Case example* —

McDonald's. A McDonald's franchisee in the US alleged that the franchise was an illegal tying arrangement because the franchisee had to buy three products — the franchise, a lease and a security deposit note. The franchisee's claim was unsuccessful, and the judge held that there was no illegal tie-in as all three were component parts of the overall franchise package, not separate products, and this formula is "what makes a McDonald's franchise uniquely attractive to franchisees".

— *Principe v McDonald's Corporation*⁵⁶ —

The Franchising Code (1998), released by the federal government, came into effect on 1 July 1998 to apply to franchisors that renew, extend, transfer or enter new franchise agreements with a franchisee after 1 October 1998. The Franchising Policy Council, representing franchisors and franchisees, provides advice to the government about franchising policy and the operation of the Code. The Council developed the draft of the Code.

The Code is designed to improve the standards of conduct of franchisors and franchisees, lower the cost of resolving disputes, and reduce risk and

54. The Code is in the Schedule to the *Trade Practices (Industry Codes — Franchising) Regulations*. Minor amendments were made to the Code, taking effect from September 1999. Reproduced, eg, Latimer, P, *Australian Business Law Workbook*, CCH Australia Limited, 2nd ed, 1999, Ch 9; Attorney-General's legislative database at <http://scaleplus.law.gov.au>. This Code replaced

the voluntary self-regulating Franchising Code of Practice, in force from 1993 to 1996, which was contained as an appendix in Franchising Task Force, *Final Report*, Canberra, 1991; interim authorisation (¶8-630) granted by ACCC: ACCC Journal, Issue 3, p 51 (June 1996).

55. ACCC Journal, Issue 2, p 15 (April 1996).

56. 631 F 2d 303 (1980).

generate growth by increasing the level of certainty for all participants in the industry.

The Code attempts to raise awareness of the rights and obligations of franchisors and franchisees and to encourage information, education, and compliance with the Code. The Code attempts to address the imbalance of power between franchisors and franchisees.

The Code is legally enforceable as it is “prescribed” by the *Trade Practices Act 1974* (Cth) sec 51AE (¶7-500). This makes compliance mandatory for all companies, and the remedies of the *Trade Practices Act* apply to breaches of the Code, such as injunctions (sec 80: ¶8-810), corrective advertising (sec 80A: ¶8-830), damages (sec 82: ¶8-840), enforceable undertakings (sec 87B: ¶8-866) and other orders (sec 87: ¶8-860).

The ACCC administers the Code, and can take action against a franchisor for non-compliance. Private individuals as well as the ACCC can take court proceedings for breaches of the *Trade Practices Act* and the Code.

The ACCC keeps a register of notices of persons who have agreed to be bound by the Code or who have withdrawn from being bound by it: sec 95.

The Franchising Code of Conduct provides for:

Part 2: Disclosure by the franchisor. A franchisor must give a “disclosure document” set out in Annexure 1 to a franchisee or to a proposed franchisee, which includes:

- advice before entering the agreement, including a recommendation that the franchisee obtain independent legal, accounting and business advice before signing the franchise agreement (set out in the Introduction);
- information on the franchisor, its name, address, the people associated with it and the business experience of the franchisor and its people over the preceding 10 years (clauses 2, 3 of the disclosure document);
- details of any present or past litigation involving the franchisor (going back up to 10 years);
- details of intellectual property (¶3-470);
- details of prepayments, financing, obligations and the conditions of the franchise agreement and earnings information.⁵⁷

Part 3: Conditions of franchised business. The Code provides for:

- a cooling-off period, under which a franchisee may terminate an agreement within seven days after the earlier of entering into the agreement or paying any money under the agreement. (This does not apply to renewal, extension or transfer of an existing franchise agreement.)

57. eg Zumbo, F, *Disclosure in franchising*, LSJ, Vol 38, No 3, p 52 (April 2000).

If so, the franchisee is to be refunded within 14 days all moneys paid less the reasonable expenses of the franchisor (cl 13);

- a copy of the lease (or any other occupation agreement: ¶3-740) to be given to the franchisee if the premises are leased from the franchisor or from an associate of the franchisor (cl 14);
- no exclusion: there is no release of the franchisor from liability (cl 16) (compare ¶7-170);
- details to be given of any marketing or other co-operative funds to which the franchisee must pay money, including an audited annual financial statement for the last financial year of the fund, unless 75% of the franchisor's franchisees in Australia agree otherwise (cl 17);
- disclosure to the franchisee of materially relevant facts within 60 days (cl 18);
- the giving of the Part 2 disclosure document to the franchisee within 14 days (cl 19);
- details to be given of the method of transfer of the franchise (cl 20);
- termination — where there has been breach by the franchisee (cl 21), no breach by the franchisee (cl 22) and termination under special circumstances (cl 23).

Part 4: Resolving disputes. Part 4 of the Code provides a “complaint handling procedure” for resolving disputes. This is commenced by a party with a complaint (the complainant) advising the respondent in writing of the nature of the dispute, the desired outcome and what action the complainant thinks will settle the dispute. The Code requires the parties to try to agree about how to resolve the dispute.

If the parties cannot resolve the dispute within three weeks, either party may refer it to a mediator (¶1-442). If they cannot agree on a mediator, the Code provides that either party can refer to a “mediation adviser” (appointed by the Minister) to appoint a mediator within 14 days (cl 29).

The Code does not affect the right of the parties to take legal action under the franchise agreement (eg for breach of contract, negligence, breach of *Trade Practices Act* sec 52: ¶7-250). The Code provides that the parties are equally liable for the costs of the mediation unless they agree otherwise, and that the parties must pay for their own costs in the mediation.⁵⁸

¶9-987 Establishment. A franchise is normally set out in a written franchise agreement between the franchisor and the franchisee. The agreement covers such matters as the duration of the franchise, ways by which it can

58. See, eg, *Franchising Code of Conduct*, ACCC Journal, Issue 15, p 19 (June 1998); Garrison, T, *Mandatory*

franchising code of conduct (1998) 72(9) LIJ 35.

be terminated, and a restrictive covenant restricting the franchisee's business activities after the franchise has ended (§5-860).

In addition, franchise documentation usually includes a licence agreement to use the name of the franchise and any trade marks owned by the franchisor; a lease, sub-lease or licence (§3-740) to use premises (such as a shop in a shopping centre), and, if the franchisee is a company, personal guarantees (§13-360) by the directors of the company.

The *Petroleum Retail Marketing Franchise Act 1980* (Cth) and the Code of Practice require franchisors to provide franchisees and intending franchisees with information on the franchise such as details of payments to be made by the franchisee and method of termination of the franchise. The Code requires a disclosure document, which contains a viability statement and key financial information from the franchisor's directors/principals, to be given to all prospective franchisees.

Under the Code, franchise agreements contain a seven-day cooling off period during which time the franchisee may terminate. A franchisee who terminates is to be refunded all moneys paid, less an allowance for the reasonable expenses of the franchisor.

Conduct of franchisor and franchisee. Both the *Petroleum Retail Marketing Franchise Act 1980* (Cth) and the Code target conduct: the former provides that franchisors will not impose unreasonable obligations, and the latter prohibits unconscionable conduct (§5-730; §5-755: *Ultra Tune*). The Code sets out the types of behaviour that must be avoided, such as overvaluation of fees and prices, conduct that is unreasonable in relation to the risks and the protection of the legitimate business interests of the franchisor, the franchisee or the franchise system. The Code equally prohibits unconscionable conduct by franchisees and franchisors.

Some franchise disputes are dealt with as "misleading or deceptive conduct" under *Trade Practices Act 1974* (Cth) sec 52 (§7-280).

§9-990 Continuity of existence. The franchise agreement will specify the duration of the agreement. The *Petroleum Retail Marketing Franchise Act 1980* (Cth) specifies that a franchise agreement shall normally be not less than three years.

§9-991 Limitation of liability. The franchisee runs an independent business, and it is accepted that there is not usually any relationship of principal and agent, partnership, joint venture or employer and employee between franchisor and franchisee. There are some specific situations where a franchisor and franchisee may be jointly and severally liable to third parties.⁵⁹

59. eg *Estate Agents Act 1980* (Vic) sec 43(3);
Real Estate and Business Agents Act 1978
 (WA) sec 56(3).

In the early days of franchising there was the possibility that the franchisor might be liable as principal for the actions of the franchisee as its agent (§11-260). Because of the nature of modern franchising, this is not normally the law in Australia today.

— *Case example* —

Dairy Queen. Christine Singleton (aged 19) was injured at the local Dairy Queen store when she pushed on the metal crossbar of the glass door and fell through the door on to the cracked glass. When she sued the franchisee and the franchisor (International Dairy Queen Inc), the franchisor claimed that the franchisee was an independent contractor. Evidence showed that because Dairy Queen retained extensive control and it did control the franchisee's day to day activities, the relationship was not that of independent contractor but principal and agent (§11-020).

— *Singleton v International Dairy Queen Inc*⁶⁰ —

¶9-992 Control. The nature of the franchise is such that the franchisee normally runs a quasi-independent business, with ongoing marketing, business or technical assistance from the franchisor. The franchisor normally retains some control, as uniform standards are basic to a franchise.

Control normally relates to the business format. For example, Ray Kroc, the founder of McDonald's, stated that his franchise system "was not going to get involved in being a supplier for its operators ... Once you get into the supply business, you become more concerned about what you are making on sales to your franchisee than with how his sales are doing".⁶¹ The franchisee is not usually agent, partner, joint venturer or employee of the franchisor and is more like the customer of the franchisor.

Practical issues to be considered by an intended franchisee include:⁶²

- (1) record-keeping — what was said by the franchisor at the outset and what inducements, if any, were made?
- (2) personal considerations, such as the time to be invested in the business and its effects on lifestyle.
- (3) expectations of, eg, income, capital gain.
- (4) verification of information, such as research and talking to other franchisees.
- (5) the landlord. If premises are to be leased, what is the record of the landlord? If the landlord is a shopping complex, what is its management record?
- (6) assessment of the competition.

60. 332 A 2d 160 (1975).

61. Kroc, R and Anderson, R, *Grinding it out: the Making of McDonald's*, St Martin's Paperbacks, 1987, pp 79-80.

62. Based on Phillips, R, *Purchasing a franchise* (1995) 69 LIJ 670.

- (7) assessment of financial considerations, bearing in mind the risks in entering any new business.
- (8) buying stock. Does the franchisor supply the stock? Does the franchise specify approved suppliers, or is the franchisee free to choose suppliers?
- (9) assessment of training and ongoing support. What are the procedures for dispute resolution?
- (10) borrowings, if any, should be conservative, and the ability to repay from the business should be assessed.
- (11) royalties. A franchise may impose a weekly royalty charge of around 6%–8% on turnover.
- (12) the franchise agreement is drafted by the franchisor and is weighted in favour of the franchisor.⁶³

¶9-995 Formalities. The formalities to be complied with are those applying to any other business — business names, licences, tax, local government, insurance, finance, leases, etc. If the parties are incorporated, they will be subject to the Corporations Law.

Franchisors, advisers (such as accountants) and service providers (such as banks) who have certified their agreement to comply with the code are bound by its provisions, such as its dispute resolution procedures.

¶9-996 Admission of new investor/participator/sale of the franchise. The franchise is the franchisor's grant to the franchisee, and as such is personal to the franchisee. Assignment (¶13-340) is one means for the franchisee to profit from its investment in the business. If a franchisor withholds consent to a franchisee who wishes to assign the franchise to an appropriate third person, this may be unreasonable — or unconscionable (¶5-755—¶5-760).

Procedure for assignment of the franchise is important to the franchisee, and this is one of the matters to be set out in the franchisor's disclosure document.

The *Petroleum Retail Marketing Franchise Act 1980* (Cth) prohibits a franchisor from unreasonably withholding consent to a franchisee's assignment of the franchise (sec 11).

¶9-997 Cessation of business. The franchise agreement will specify the reasons for ending the franchise — such as breach of a condition of the franchise by the franchisee. Section 16 of the *Petroleum Retail Marketing Franchise Act 1980* (Cth) prohibits termination by the franchisor except on

63. Compare the *contra proferentem* rule of interpretation: ¶6-240.

one of the specified grounds. The terms and conditions relating to termination are to be set out in the disclosure document required under the code.

It is important that the terms and conditions for termination be set out clearly, because there is the possibility that the franchisee may forfeit an up-front payment if there is unscrupulous termination of a franchise by a franchisor for a technicality.

In the absence of any specific agreement or other cause, goodwill built up by the franchisee belongs to the person largely responsible for the reputation of the business, the franchisor.

The franchisee's authority to continue selling the franchisor's products ends on termination of the franchise.

Chapter 10

Partnership

THE REGULATION OF PARTNERSHIP	¶10-010—¶10-040
DEFINITION AND NATURE OF PARTNERSHIP	¶10-050—¶10-190
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THE REGULATION OF PARTNERSHIP

Governing law	¶10-010
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Advantages of a partnership	¶10-030
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¶10-010 Governing law. Most partnership law is contained in the largely uniform *Partnership Act* of each jurisdiction.¹ However, the *Partnership Act* is not a complete code of partnership, as it expressly states that the “... rules of equity and of common law applicable to partnership shall continue

1. *Partnership Act 1958* (Vic); *1892* (NSW); *1891* (Qld); *1895* (WA); *1891* (SA); *1891* (Tas); *1963* (ACT). The SA Act applies in the NT; these are all adapted virtually unchanged from the original English Act of 1890, as are those in the USA, Malaysia

and most English language jurisdictions. The Qld Act was revised in the 1994 reprint in modern format and gender neutral language. Similarly, the NSW Act was revised in gender neutral language in 1994.

in force except so far as they are inconsistent with the express provisions of this Act.”²

Many areas are not legislated for in the *Partnership Act* and these are covered by other legislation or by case law, eg the formalities on the contract of partnership (these are left to the rules of contract) and the fiduciary obligations between partners (§10-370).

Many jurisdictions permit a special form of partnership to be formed, called a limited partnership (§10-190).

There is no specific federal legislation regulating partnership law in Australia, though some aspects of the operation of partnerships are regulated by tax law and by the Corporations Law. Certain conduct of partners or partnerships may be caught by the *Trade Practices Act 1974* (Cth) (such as misleading or deceptive conduct (§7-250), or anti-competitive practices (Chapter 8)).

¶10-020 Important preliminaries. “Partnership” and “firm” are synonymous words, as the Act makes clear:³

“Persons who have entered into partnership with one another are for the purposes of this Act called collectively a firm and the name under which their business is carried on is called the firm-name.”

But neither a partnership nor a firm is a separate legal entity like a company, and each partner remains an individual, although part of a firm, bound to the other partners by the partnership agreement, written, oral or implied.

In any study of partnership law, there are a number of important matters to start with:

- *Caveat emptor*. Partnership is one of the last areas of law where the doctrine of *caveat emptor* (let the buyer beware) applies. This must be read in the light of the provisions of the *Trade Practices Act 1974* (Cth) and the *Fair Trading Act* equivalents, which prohibit misleading or deceptive conduct (sec 52: §7-250ff) (including representations as to future matters sec 51A: §7-287) and false or misleading representations (sec 53: §7-290ff).⁴

A prospective partner must realise that because personal liability is unlimited, all private assets as well as capital contribution are at risk.⁵

- *Ease*. It is usually easier to enter a partnership than to retire from it.

2. Vic sec 4; NSW sec 46; Qld sec 48; SA sec 46; Tas sec 5; WA sec 6; ACT sec 5.

3. Vic sec 8; NSW sec 4; Qld sec 3; SA sec 4; Tas sec 9; WA sec 10; ACT sec 8.

4. eg *Maisey v Mudgeeraba Village Estates Pty Ltd* (1985) ATPR ¶40-569 (damages awarded under the *Trade Practices Act*

and negligent mis-statement on failed investment in a limited partnership).

5. See, eg, Foster, T, The partnership offer, *Chartered Accountant*, Vol 60, No 2, p 48 (March 1989); Knights, RC, *Assessing an offer of partnership*, LSJ, Vol 29, No 4, p 68 (May 1991).

- *No formalities.* To enter into a partnership there are no special formalities involved. Just the fact of carrying on business in common may be sufficient to show to the world that the persons are operating as partners. In other words, any agreement, express or implied, will do. But there are some precautions to note:
 - (1) A partnership contract lasting for more than one year must be evidenced in writing to comply with the Statute of Frauds in some jurisdictions (and its modern re-enactments: ¶5-030).
 - (2) If a partnership proposes to carry on business under a name different from the actual names of the partners, the name must be registered under the relevant *Business Names Act* (see Chapter 12).
 - (3) Legislation imposes certain limitations on a partnership. Under the Corporations Law sec 115, the size of associations (¶9-630) and partnerships that can be formed for profit-making purposes is restricted to 20 persons. However, the Minister has made “application” orders under sec 111A for partnerships of more than 20 in the case of the following:
 - (a) An accounting practice may consist of not more than 1,000 persons, and a legal practice may consist of not more than 400 persons.
 - (b) Architects, pharmaceutical chemists and veterinary surgeons may form partnerships of not more than 100 persons.
 - (c) Actuaries, medical practitioners, patent and trade mark attorneys, and stockbrokers may form partnerships of not more than 50 persons. In fact since deregulation (1984; see ¶8-660) most sharebrokers and stockbrokers now operate through limited liability companies.
 - (4) Anti-discrimination and equal opportunity legislation applies to some partnerships to ensure that potential or current partners are not denied partnership opportunities because of personal characteristics unrelated to performance such as age, intellectual impairment, marital status, physical impairment, political beliefs, pregnancy, race, religion, sex and sexuality.⁶
- *Professional restrictions.* Some professions such as dentists,⁷ doctors,⁸ and patent attorneys⁹ specify that a qualified person cannot enter a

6. eg partnerships of six or more: *Sex Discrimination Act 1984* (Cth) sec 17; *Anti-Discrimination Act 1977* (NSW); *Anti-Discrimination Act 1991* (Qld) sec 17-18; five or more: *Equal Opportunity Act 1995* (Vic); noted Fletcher, KL, Higgins and Fletcher — *The Law of Partnership in Australia and New Zealand*, LBC Information Services, 7th ed, 1996, p 81; Jackson, R, *The Equal*

Opportunity Act 1995, LIJ, Vol 70, No 3, p 18 (March 1996).

7. eg *Dentists Act 1984* (SA) sec 35; *Dental Act 1939* (WA) sec 55.

8. eg *Medical Practice Act 1994* (Vic) sec 62; *Medical Practitioners Act 1983* (SA) sec 30, 39.

9. *Patents Act 1990* (Cth) sec 201.

partnership with an unqualified person. Multi-disciplinary law practices with non-solicitor partners are developing in some jurisdictions to fulfil the demand for seamless legal, accounting and other professional advice.¹⁰

The two accounting bodies permit a minority component of non-members in accounting partnerships in some circumstances, so that, for example, a solicitor could become a minority shareholder in an accounting firm. Some professions permit incorporation of practices.¹¹

Attempts by high-income earners to split income with low-income family members have given rise to numerous tax avoidance cases brought by the Australian Taxation Office.

By tradition, barristers cannot enter partnerships with each other, and they continue to operate as “sole traders” generally but not necessarily in barristers’ chambers sharing (at a price) no more than facilities and libraries (¶1-040). Breach of this practice is considered improper and contrary to the etiquette of the bar.¹²

¶10-030 Advantages of a partnership. The advantages of a partnership can be summarised as follows:

- *Informality and inexpensiveness* in setting up. No formalities are necessary.
- *Flexibility.* The nature of the business can be easily altered by agreement.
- *Secrecy.* There is no registration of documents or other regulation by the (federal) Australian Securities and Investments Commission or by the (State) Corporate Affairs Commission or equivalent (except by the latter in the case of limited partnerships (¶10-190) and business names (¶10-020)).

10. Multi-disciplinary partnerships prohibited under, eg, *Legal Practice Act 1996* (Vic) sec 317; *Legal Practitioners Act 1893* (WA) sec 79; multi-disciplinary partnerships permitted under, eg, *Legal Profession Act 1987* (NSW) sec 48G. In 1998, the Law Council recommended multi-disciplinary partnerships of lawyers and non-lawyers on the basis that it is the individual, not the partnership, that is the subject of regulation. For example, New South Wales is proposing profit-sharing with non-solicitors, incorporation of law firms and the listing of legal practices on the stock exchange.

11. The Institute of Chartered Accountants permits its members to provide

professional services through incorporated companies; non-Institute members may be directors and shareholders, provided they are not described as “chartered accountants” and control is with Institute members.

12. *Home v Douglas*, *The Times*, 15 Nov 1912. See Ward, K, *Comment* (1951) 25 ALJ at p 309. Note also: “while solicitors may form partnerships with other solicitors, barristers must practise independently”, Harper, DL, Kirkham, AJ and McIntosh, AJ, *The Victorian Bar — its work and organisation*, Victorian Bar Council, 1990, p 12; ¶1-040.

- *Partnerships do not pay tax.* Tax is not paid by partnerships, but is instead paid by the partners. (A partnership return is lodged, however, more as a statistical and cross-referencing exercise.)
- *Automatic checks and balances.* A partnership can be seen as the first line of self-regulation. Partners can discuss and resolve problems which may appear insoluble to a sole trader, and, in addition to sharing the loads of the business, a partner can act as a conscience in relation to the handling and the application of business matters, clients' funds, etc.

¶10-040 **Disadvantages of a partnership.** The disadvantages of a partnership can be summarised as follows:

- *Liability.* Each partner will face an unlimited liability for the debts and obligations of the firm.
- *Transfer of interest* is not as easy as the transfer of shares in a company. There is no market for the transfer of shares in partnerships beyond, say, advertisements in solicitors' journals and the like.
- *Numbers are limited* (see ¶10-020).
- *Persons who can be partners are limited* by other bodies such as the Australian Medical Association (see ¶10-020).
- *Unanimous decisions will be needed* for a number of matters under the Act, such as a change in membership. This means that a difficult partner could prove to be a real obstacle at such a time unless this particular provision of the Act is overridden by agreement of the partners to a contrary provision, eg that in certain matters decisions can be made by a majority of partners or by one particular partner.
- *Agency.* Because each partner is bound by the actions of the co-partners acting in the course of their authority, each may be to some extent at the mercy of the co-partners. **Partners should therefore be chosen carefully.**

DEFINITION AND NATURE OF PARTNERSHIP ____

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¶10-050 Statutory definition. The *Partnership Act*'s definition of a partnership states that:¹³

"... (1) Partnership is the relation which subsists between persons carrying on a business in common with a view of profit.

(2) But the relation between members of any company or association which is—

- (a) registered as a company under any Act for the time being in force and relating to the registration constitution or incorporation of companies; or
- (b) formed or incorporated by or in pursuance of any Act or letters patent or Royal Charter—

is not a partnership within the meaning of this Act."

Unlike a company, a partnership is not a separate legal identity. No formal agreement is necessary to establish a partnership and the mere fact that two people carry on business together may be sufficient to indicate that a partnership in fact exists. Indeed, a partnership may exist in law even if the parties are unaware that they are in fact partners. This is especially so in the context of a business operated by a husband and wife, which, if it fulfils the tests of partnership (¶10-060), may be a partnership under the *Partnership Act*.¹⁴

Similarly, a joint venture may qualify as a partnership if these tests are met: ¶9-150.

¶10-060 Indications of partnership. Most professional and business partnerships are evidenced by a partnership deed. But without a formally constituted arrangement, for example where two brothers are running a workshop, or two sisters are developing real estate, the question may have to be asked, how can you tell if a partnership exists? There are four requirements based on the definition section of the Act which must be satisfied.

(1) *Is there a valid agreement between the parties?* An agreement in this context need not be formally made; any implied agreement which can be inferred from the circumstances will do, so long as it can be inferred that the partners have entered a "relation" between themselves for the carrying on of a business in common with a view of profit.

(2) *Is there a business being carried on?* The Act defines "business" as including "every trade, occupation or profession".¹⁵ Because the word used in the definition is "include", the definition is not to be taken as final or exhaustive, but it provides some examples of what the concept of "business" can include. Business indicates "an active occupation or profession continuously carried on".¹⁶

13. Vic sec 5; NSW sec 1; Qld sec 5; SA sec 1; Tas sec 6; WA sec 7; ACT sec 6.

14. The interests of a husband and wife in a partnership can be dealt with by the Family Court (¶1-140).

15. Vic sec 3; NSW sec 45; Qld sec 3; SA sec 45; Tas sec 4; WA sec 3; ACT sec 4.

16. *Commissioner of Inland Revenue v Marine Steam Turbine Co Ltd* [1920] 1 KB 193 at p 203.

— Case example —

Unit trust. A trust was set up to buy shares in various companies to be held for investors with the funds they subscribed. The investors were issued with certificates in the trust (like units in a modern unit trust: ¶9-800), which gave them certain legal rights including interest on the nominal amount of the certificate. One investor applied to have the trust wound up alleging that, because of the number of investors, the trust was an illegal partnership (because there were more than 20 people: ¶10-020). This claim failed: “carrying on a business” implies repetition of acts and excludes an association set up to do one act which is never to be repeated. (In this case, the one act was to buy the shares on trust.) Even though the investors in the trust had a common interest, there were no mutual rights or obligations between them as there would be with partners and they were not carrying on business “in common”.

*Smith v Anderson*¹⁷

Carrying on a business involves continuity and system:¹⁸

“... whether one or two transactions make a business depends on the circumstances of each case. I take the test to be this: if an isolated transaction, which if repeated would be a transaction in a business, is proved to have been undertaken with the intention that it should be the first of several transactions, that is, with the intent of carrying on a business, then it is a first transaction in an existing business. The business exists from the time of the commencement of that transaction with the intent that it should be one of a series.”

In the words of *Emmett J*, “... mere repetitiveness is not sufficient to constitute carrying on of a business. System and regularity are involved in the carrying on of the business but it does not necessarily follow that one who has transactions of the same kind systematically or regularly is carrying on a business in those transactions. The example of regular deposits to a bank account is sufficient to explain that proposition. Absence of a system and regularity might deny that a business is being carried on but the presence does not necessarily establish that it is”.¹⁹

Single venture partnerships. A partnership may exist in respect of a single joint venture (¶9-150) if there is evidence that the parties are “carrying on a business in common” as partners, such as where co-owners develop, improve or subdivide jointly owned land (¶10-080).²⁰

17. (1880) 15 Ch D 247.

18. *United Dominions Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1; (1985) 59 ALJR 676, per *Dawson J* at CLR p 15; ALJR p 681.

19. *JS McMillan Pty Ltd v Commonwealth of Australia* (1997) ATPR (Digest) ¶46-175 at p 54,402.

20. *Webb, PRH, Single venture partnerships*, [1971] NZLJ 347.

— *Case examples* —

Where the owners in common of a racehorse agreed to share winnings and expenses, it was held that although there was the hope of profit, there was no business.

*French v Styring*²¹ —

A contract between A and T specified that "It is understood that we are to have one-fourth interest in T's remaining stock of rice ... We are to receive 2½ per cent commission on all rice sold through our hands. (Signed) A, agreed T." A loss of £6,000 was incurred by A, and, when T sued A for the price, A raised the defence that because the transaction constituted a partnership, T could not recover from A. This view was rejected and the court held that the agreement constituted no more than a sale of goods, and therefore T could recover from A.

*Turnbull v Ab Mouy*²² —

The relationship between the owner and the driver of a taxi was held not to be a business. Each ran his own business, because the owner exercised no control over the driver, who paid a percentage of the takings to the owner.

*Checker Taxicab Co Ltd v Stone*²³ —

(3) If there is a "business", is it being carried on by "persons in common"?

The test of this requirement is that the business is being carried on by or on behalf of all the partners. All the partners need not take an active role in management, but agency is the test. The persons carrying on business must be doing so as agents for the other partners, such that they can bind the others, and they therefore face the duty of acting in the interests of the others.

But agency is insufficient to indicate that a business is being carried on in common. If that were the case, every agent would be the partner of the principal. There must be a mutuality of rights and obligations between the persons on whose behalf the business is carried on. A common interest in property or business in itself is not enough unless this added factor of mutuality of rights and obligations is present.

— *Case examples* —

A and B were in the process of setting up a restaurant business. Before its incorporation as a company, A ordered some goods from P. When the goods were not paid for, P sued B, arguing that B was a partner of A. The action failed on the basis that at the time there was no evidence of "business in common with a view of profit". Rather, it was held that there was preparation for the carrying on of business as a company as soon as possible.

*Keith Spicer Ltd v Mansell*²⁴ —

21. (1857) 2 CB (NS) 357; 140 ER 455.

23. [1930] NZLR 169.

22. (1871) 2 Australian Jurist Reports 40.

24. [1970] 1 WLR 333; [1970] 1 All ER 462.

Because there was no evidence of intention by a builder and property owners to enter a partnership, a profit making venture between them to buy, develop and sell land and share the profits did not of itself involve the participants in “business in common”. The builder was to build on land owned by the investors and to be responsible for building debts. There were no meetings, no common bank account and no fiduciary obligations (¶9-770; ¶10-370) between co-owners.

————— *Keith Murphy Pty Ltd v Custom Credit Corporation Ltd*²⁵ ———

A company syndicated its office building into 20 one-twentieth shares, and sold the building by selling the shares to investors. The investors were held to be partners: “The existence of a partnership is determined by reference to the true contract and intention of the parties as appearing from all of the facts and circumstances relevant to the relationship of the parties.”

————— *Amadio Pty Ltd v Henderson*²⁶ ———

(4) Is there “a view of profit”? Profit in partnership law follows the balance sheet approach, namely the gain made between accounting periods, which is traditionally determined by comparing the value of the assets of the business at two different points in time. This fails to take into account the more accepted accounting method of profit measurement, namely the calculation of operating revenues less operating expenses over the period. It also fails to take into account price level adjustment problems. The section really only requires “profit” in the lay sense.

However, this section does not require mutual participation in profit and loss, although this point is caught later in the Act by a section²⁷ which says that each partner has a right to an equal share in the profits.

What the requirement of profit really does is to exclude clubs and societies from the ambit of partnership law. Tennis clubs and the like, even if they operate at a profit, are not by their very nature likely to be carrying on a business. This means that no member of a club can become liable to pay to the funds of the club or to anyone else an amount in excess of the membership subscription. A committee member may, however, be found liable if it is shown that the committee member has assumed responsibility for the club’s debts. This principle has been recognised by the courts in proceedings for the winding up of a club.²⁸

25. (1992) 6 WAR 332; ¶5-670.

26. (1998) 81 FCR 149 at p 172; ¶5-825; ¶10-240.

27. Vic sec 28; NSW sec 24; Qld sec 27; SA sec 24; Tas sec 29; WA sec 34; ACT sec 29; ¶10-430.

28. *In re St James’s Club* (1851) 2 De GM & G 383; 42 ER 920; ¶9-680 — ¶9-690.

¶10-070 Rules for determining existence of partnership.

Because the partnership relationship is essentially contractual, the question of what was or was not agreed to can play a major role although it is not necessarily conclusive.²⁹ The existence or otherwise of a partnership can be determined by having regard to the “rules” which are set out in the *Partnership Act*.³⁰ These rules are discussed one by one below.

¶10-080 Rule 1: co-ownership. The *Partnership Act* says:

“... (1) Joint tenancy tenancy in common joint property common property or part ownership does not of itself create a partnership as to anything so held or owned whether the tenants or owners do or do not share any profits made by the use thereof.”

Subsection (1) makes clear that co-owners of property who share profits are not partners unless the partnership tests set out at ¶10-060 are fulfilled. For example, investors buying jointly owned property as a syndicate with the intention of making a profit on resale are not necessarily partners.³¹

Co-ownership and partnership have many differences. Co-owners are not agents of each other, and co-owners do not usually share profits or losses. Partners carry on business in common. A partnership interest cannot be transferred without the agreement of the other partners.

— Case example —

A father left his business and three houses to his two sons in equal shares as tenants in common (¶13-190). One of the houses had been let and the other two were used as workshops by a small business. The sons carried on with the business, and, although they never entered a formal partnership agreement, each drew weekly pocket money from the business. They borrowed money on the security of the houses, and the question arose whether the business had become a partnership and, if so, whether the houses had become partnership property. It was held that this co-ownership would have been *prima facie* evidence of partnership unless rebutted by something else. Finding nothing to rebut this presumption, and with the evidence of the sons' continuation of the business, the court inferred the existence of a partnership.

The court concluded that because the brothers drew the same amount each week, they must have made some agreement to divide the profits equally. If the brothers had drawn differing amounts each week, the court might not have been able to arrive at this conclusion.

— *Davis v Davis*³² —

29. *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd* (1974) 131 CLR 321; detailed at ¶9-150.

31. eg *Williams v Robinson* (1891) 12 LR (NSW) Eq 34; 7 WN (NSW) 153.

32. [1894] 1 Ch 393.

30. Vic sec 6; NSW sec 2; Qld sec 6; SA sec 2; Tas sec 7; WA sec 8; ACT sec 7.

¶10-090 **Rule 2: sharing of gross returns.** Subsection (2) reads:

"... (2) The sharing of gross returns does not of itself create a partnership whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived."

Again, subsec (2) is making clear that the sharing of profits is not enough to create a partnership. Co-owners of property sharing rent or co-owners of a stud on hire are not partners by reason alone of receipt and division of the profits.

— *Case example* —

P was employed by A as an agricultural worker. A leased part of his land to B and under the agreement A was to provide B with stock and machinery. B agreed to pay A half the sale proceeds of the farm's output. P continued to work on the land and in the course of his employment P suffered injuries and sued not A but B on the basis that A and B were partners. Was the agreement that of a partnership operating a business of farming, or of a tenancy? It was held that there was no mutuality of ownership because B did not have any rights over A or the working of A's land and therefore the agreement was that of tenancy only, for which the farm proceeds were rent. Therefore, P could not sue B as a partner of his employer A.

— *Cribb v Korn*³³ —

¶10-100 Rule 3: sharing of profits and losses. The sharing of the profits and losses of a business does not necessarily mean that those who are sharing are partners. The sharing of profits and losses indicates partnership, but the whole scope of the agreement must be looked at before any presumption of partnership can be made, and the tests set out at ¶10-060 must be fulfilled for there to be a partnership.

In the words of subsec (3):

"... (3) The receipt by a person of a share of the profits of a business is prima facie evidence that that person is a partner in the business, but the receipt of such a share or of a payment contingent on or varying with the profits of a business does not of itself make that person a partner in the business ..."

— *Case examples* —

The Stanton Iron Company was a partnership in financial difficulties. To bail themselves out, the partners assigned the business to trustees (who were also creditors) who were to manage the firm until all debts were paid (cf ¶13-553). A bill of exchange was accepted on behalf of one of the trustees "per pro Stanton Iron Company" (¶16-560). When the firm dishonoured the bill, the drawer, Hickman, sued Cox, who was one of the creditors and a retired trustee, on the basis that the sharing of the profits was not the only test of partnership, and that the tests as set out in ¶10-060 must also be fulfilled. The action failed.

— *Cox v Hickman*³⁴ —

33. (1911) 12 CLR 205.

34. (1860) 8 HL Cas 268; 11 ER 431.

A paid to import TV sets from England and B, who did not have an import licence, installed and serviced them. The fact that A and B shared the profits of the joint venture (¶9-150) did not of itself make them partners. The TV sets were not bought by A as agent for any A/B partnership, and they were therefore not partnership property.

— *Elkin & Co Pty Ltd v Specialised Television Installations Pty Ltd*³⁵ —

Three brothers ran a family business in partnership, which they ran with their mother in conjunction with their accountant. All family members “hopped in”, including their father. Although the five had no intention to enter into a partnership, the father was held to be a partner “at law” because he was described as a partner in insurance documents, was a co-signatory on the firm’s bank account and his car was registered in the name of the partnership.

— *DC of T v Tuza*³⁶ —

Whether or not the relationship does exist must depend on the real intention of the parties and the contract between them. Reliance on one term of the arrangement only — that to do with sharing the profits — is insufficient to prove the existence of a partnership.

Subsection (3)(a) covers the situation where debt repayments are related to profits:

“... (3)(a) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make that person a partner in the business or liable as such”.

This rule embodies the decision in *Cox v Hickman*. But if there are other circumstances showing that the relationship is in fact a partnership (eg if the lender allows himself to be represented as a partner), the lender may be held liable as a partner regardless of the state of mind of the partners.

— Case example —

An engineer and iron-founder was in debt to the grandmother of one of his employees. He entered into an agreement with her whereby she was to purchase a one-quarter share in the business for the ultimate benefit of the grandson. The purchase price of this one-quarter share was to be considered as paid by the discharge of the debt owing to the grandmother. When the debtor was declared bankrupt, could his creditors claim against the grandmother as his partner? Yes. This may sound unfair, but, notwithstanding an agreement between her and the debtor that she was not to be liable for business losses, the reality was that she retained all the rights of a dormant partner. She was consulted on “partnership” matters and they treated each other as partners of the engineering and iron-foundry business.

— *Re Ruddock*³⁷ —

35. (1961) 61 SR (NSW), applied in the *Tuza* case.

36. (1995) 31 ATR 261. In earlier tax returns the father had received a share of the partnership income and had been described as a partner.

37. (1879) 5 VLR (IP & M) 51. See also *John Bridge & Co Ltd v McGrath* (1904) 4 SR (NSW) 441.

It was the fact of the partnership relationship, and the grandmother's approach to the business, that was held to make these facts different from those in *Cox v Hickman*, where the creditors' trustees at all times considered themselves trustees of somebody else's business, rather than managers of their own business.

¶10-110 Sharing of losses. The existence of an agreement to share losses as well as profits will enhance the view that there is a partnership. The fact that there is no arrangement to share losses is not necessarily important in analysing whether a partnership exists, but there may be some doubt if the losses are not to be shared.

In the *Canny Gabriel case* (detailed at ¶9-150) the absence of any agreement to share losses in the "joint venture" did not mean that no partnership existed. The High Court found that all the tests of partnership were satisfied in the joint venture "except that it did not describe the parties as partners and did not provide expressly for the sharing of losses, although we venture to think that it did so impliedly."³⁸

However, even if a contract between the parties for a specific venture may not be construed as a partnership (¶10-060), it may still be possible to imply a term into the business contract that any losses of their venture are to be borne equally. This was in fact done in the case involving Ashtons Circus and Channel 7 Adelaide concerning the loss suffered in the parties' promotion of the Spanish circus Los Muchachos.³⁹

¶10-120 Profit sharing: contract of employment. Profit sharing between employer and employee does not necessarily infer partnership unless they are running a business in common with a view of profit (¶10-060):

"... (3)(b) a contract for the remuneration of a servant or agent of a person engaged in a business by a share of the profits of the business does not of itself make the servant or agent a partner in the business or liable as such".

Unless there were a provision like this, any profit-sharing arrangement between employer and employee would place the employee in danger of being considered a partner and therefore of being liable for the debts of the employer. Mere receipt of a share of the profits will not make an employee a partner unless the tests in ¶10-060 are fulfilled.

— *Case example* —

A clerk in a firm of tea merchants entered into an agreement with his employers for a salary plus a one-eighth share of the net profits (or a one-eighth share of the firm's losses) in consideration for making an advance to the firm of £1,500. But after the agreement, the clerk's status remained

38. *Canny Gabriel case* (1974) 131 CLR 321 at p 327.

39. *Television Broadcasters Ltd v Ashton's Nominees Pty Ltd (No 1)* (1979) 22 SASR 552.

the same. The name of the firm was not changed, and the clerk took no part in the management of the firm. When the clerk was given notice of dismissal in the following year, he retaliated by applying for a court order to wind up the firm on the basis that he was a partner (compare ¶10-440; ¶10-490). This action failed because the facts showed that the clerk had no management authority and that he had remained an employee at all times.

*Walker v Hirsch*⁴⁰ —

¶10-130 Profit sharing: annuities on death of partners.

An annuity or pension paid by the firm to the dependants of a deceased partner does not necessarily make the dependants into partners in the firm:

“... (3)(c) a person being the spouse or child of a deceased partner and receiving by way of annuity a portion of the profits made in the business in which the deceased person was a partner is not by reason only of such receipt a partner in the business or liable as such”.

Partnership agreements often provide for the welfare of the dependants of a deceased partner such as spouse and children. This subsection makes clear that receiving a portion of the profits does not make the recipient a partner unless the tests in ¶10-060 are also fulfilled. This of course clears the spouse or dependants from any liability to creditors of the firm. Provisions in a partnership agreement for a spouse and dependants in fact create a valid trust (¶9-755) in their favour.

¶10-140 Profit sharing: loan repayments based on profits.

Subsection (3)(d) protects a creditor who has financed the business from being considered a partner of the debtor(s):

“... (3)(d) the advance of money by way of loan to a person engaged or about to engage in any business on a contract with that person that the lender shall receive a rate of interest varying with the profits or shall receive a share of the profits arising from carrying on the business does not of itself make the lender a partner with the person or persons carrying on the business or liable as such: Provided that the contract is in writing and signed by or on behalf of all the parties thereto”.

If not involved in the day to day management of the firm, the creditor will not be able to be considered a partner of the firm unless the tests in ¶10-060 are fulfilled.

— Case example —

C advanced £10,000 to A and B for the purposes of a business which A and B intended to carry on in partnership. It was an express term of the agreement that the advance was a loan and that it was not to be considered to render C a partner of A and B. That is what the parties said, but what they did was held to indicate a partnership. C was to share profits and losses to the extent of 25%: he was entitled to examine the partnership books at will; he was entitled to a quarterly statement and to cancel the arrangement if the £10,000 were reduced by half by borrower's losses. When A and B went into voluntary liquidation, C claimed as a creditor,

40. (1884) 27 Ch D 460.

but his claim was rejected on the basis that he was a partner. He was sharing the profits and was clearly involved in the management of the business in common. Indeed, his advance of £10,000 was the firm's only capital and it was said by the court that "... the business was really [C's] business".

— *Re Megevand; Ex parte Delhasse*⁴¹ —

¶10-150 Profit sharing: annuity on sale of business. The seller of a business who finances the sale of the business by accepting payment of the purchase money from future profits of the business is not considered a partner of the buyer(s) unless the tests set out in ¶10-060 are also fulfilled:

"... (3)(e) a person receiving by way of annuity or otherwise a portion of the profits of a business in consideration of the sale by that person of the goodwill of the business is not by reason only of such receipt a partner in the business or liable as such."

— *Case example* —

A medical practitioner transferred his medical practice to a purchaser under the arrangement that he would continue to reside in the house for three months and introduce patients to the purchaser. The parties had agreed that earnings and expenses would be shared equally in the three-month period, but this share in the earnings was insufficient to indicate that the vendor of the business was or was intended to be a partner of the purchaser. The arrangement was held to be an "out-and-out sale" of the practice. No partnership was intended by the parties, and services were rendered by the vendor to the purchaser for consideration.

— *Re Pratt v Strick*⁴² —

¶10-160 Salaried and silent partners

Salaried partner. A salaried partner is guaranteed a salary up to a specified amount. (In law, partners' salaries are advances in expectation of profit.) A person may be taken on as a salaried partner for a number of reasons: the person may be inexperienced and learning the business; or approaching retirement and wishing to avoid the rigours of full partnership and the many administrative matters that may be involved. But a salaried partner may not be a partner in the full legal sense and may be a mere employee. In other words, the first task is to analyse the exact status of the person in question.

It will be difficult for a salaried partner to claim to be less than a full partner if held out to the world as a full partner. While a salaried partner may have the "honour and glory" of being named on the letterhead of the firm, that comes at the cost of liability for partnership debts if held out as a partner.⁴³

41. (1878) 7 Ch D 511. See also *Re Fort; Ex parte Schofield* (1897) 77 LT 274; but refer *Pooley v Driver* (1876) 5 Ch D 458, where it was confirmed that a genuine lender is not legally a partner.

42. *Pratt v Strick* (1932) 17 TC 459.

43. eg Vic sec 18 and equivalents: partnership by estoppel; *Lynch v Stiff* (1943) 68 CLR 428; *Nationwide Building Society v Lewis* [1997] 3 All ER 498, noted (1997) 71 ALJ 746; ¶10-340.

Sleeping or dormant or silent partner. A silent partner takes no active part in the management of the partnership business, although a full partner in every respect. In other words, the Act's provision for every partner to take part in the management of the partnership business⁴⁴ is expressly excluded by a person accepting the status of silent partner. Indeed, to confirm this status, silent partners should be expressly restrained from acting in the firm's business by a provision in the partnership agreement.

Although a silent partner may be in a secret or concealed position, the silent partner will be bound by acts of the other partners acting within their authority.⁴⁵

¶10-190 Limited partnerships. Most Australian jurisdictions provide for limited partnerships as a form of business organisation to provide a further alternative to running a business as a company, association, etc (as set out in Chapter 9).¹ Except where they are governed by the limited partnership legislation, limited partnerships operate under the ordinary principles of partnership law set out in the *Partnership Act*. In recent years, limited partnerships have been used for many ventures requiring risk capital and entrepreneurial initiative such as agricultural and industrial development.

A limited partnership consists of general partners and limited partners. General partners manage the limited partnership and face unlimited liability jointly and severally for all debts and obligations of the limited partnership. Limited partners are investors who do not normally participate in management. They do have the power to participate in management and, if they do, they face the same unlimited liability as general partners. Otherwise, their liability to contribute to debts and obligations is limited to their contribution to capital. In Queensland, no contribution of money or property is required of the limited partner.

Details of limited partnerships are on public record on the Register of Limited Partnerships or equivalent. Public disclosure of the liability of a limited partner is required on the Register indicating the extent of responsibility of a limited partner for liabilities of the limited partnership. Some jurisdictions require the name of a limited partnership to be clearly identified, as for example "VL & Co, A Limited Partnership".

44. eg Vic sec 28(5); see ¶10-430.

45. eg Vic sec 9, see ¶10-210. See also Vic sec 40, ¶10-550.

1. *Partnership Act 1892* (NSW), Pt 3, amended by *Partnership (Limited Partnership) Amendment Act 1991* (NSW), noted, eg, *Hansard*, Legislative Council (NSW), 3 December 1991, p 5199; *Partnership Act 1958* (Vic), Pt 3, amended by *Partnership (Limited*

Partnerships) Act 1992 (Vic), noted *Limited Liability Partnerships* (1992) 66 LIJ 461; *Partnership (Limited Liability) Act 1988* (Qld); *Limited Partnerships Act 1909* (WA); *Limited Partnerships Act 1908* (Tas); Murphy, M, *The role of the limited partnership in the 1990s* (1996) 17 Qld Lawyer 31. *Rowella Pty Ltd v Abfam Nominees Pty Ltd*, discussed at ¶10-630, involved the winding up of a Queensland limited partnership.

With tax changes announced in 1992, limited partnerships no longer have any tax advantage over companies, especially regarding passing of losses to investors and the ability of investors to receive tax-free distributions. As from 1992, limited partnerships are to be treated as companies for tax purposes.

RELATIONS OF PARTNERS TO OUTSIDERS _____

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¶10-200 Relevance of agency law to partnership. The importance of the preceding discussion on the question of identification of a partnership (where there is no formal agreement) is apparent when the liability of partners for each other's conduct is appreciated.

Partnership is a branch of agency law:

- In partnership, there is a mutuality of rights and obligations. Each person is agent and principal of the other. Each can bind the other and can be bound by the actions of the other. In an agency, there is a one-way relationship, with one person the principal, and one the agent. The principal does not owe a fiduciary relationship to the agent as does one partner to the other.
- In partnership, the partners operate a business in common. In agency, although the business may be to the benefit of the principal and the agent, separate businesses are being conducted.

See further ¶11-010 (legal v commercial meaning of agency).

Fourteen sections of the *Partnership Act* are headed "Relations of partners to persons dealing with them" and supplement whatever may be expressly included in any formal partnership deed. Because third parties are not entitled to inspect any formal partnership agreement (as they must be able to with a proprietary company's constitution: ¶9-430), the effect of these sections is of

¶10-200

even more importance. Their effect is that any act of a partner which is done within the scope of the partnership business and in the ordinary course of business is binding on all the other partners unless the third person actually knows that this particular action is forbidden.

¶10-210 When is a partner bound by co-partners? The Act provides a section summarising the whole agency provision, headed “Power of partner to bind the firm”:²

“... Every partner is an agent of the firm and his other partners for the purpose of the business of the partnership, and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter and the person with whom he is dealing either knows that he has no authority or does not know or believe him to be a partner.”

The section comprises two distinct limbs:³

The first limb, up to “the business of the partnership”, deals with actual authority (¶11-110) and states that every partner *is* (not *is deemed to be*) an agent of the firm for the purposes of the partnership business. Actual authority can be negated or qualified by contrary agreement of the partners (eg NSW sec 19; WA sec 29: ¶10-380).

The second limb of this section starting at “and the acts of every partner ...” states the position of principal/agent ostensible authority (¶11-130) when it says that even though actual authority may be lacking, the firm will be bound if each of the following three tests is satisfied:

(1) “*Business of the kind carried on by the firm*”. A third party will only be able to hold the firm liable for an action of one of its partners if it can show that the transaction is within the scope of the kind of business carried on by the firm. Working this out is a question of fact, and can be determined by looking at all the evidence.

— *Case examples* —

A and B were partners in a firm carrying on a garage business. Without B’s authority, and in contravention of the partnership deed, A sold a car which he did not own to a finance company for £700. When the company found that A had no right to sell the car, it claimed the £700 from B. The question whether this sale was “an act for carrying on in the usual way business of the kind carried on by the firm” was answered in the affirmative.

— *Mercantile Credit Co Ltd v Garrod*⁴ —

2. Vic sec 9; NSW sec 5; Qld sec 8; SA sec 5; Tas sec 10; WA sec 26; ACT sec 9. Recommendations about securities made by a stockbroker partner “shall be deemed to have been made by each partner in the partnership” for the purposes of legal liability: Corporations Law sec 848(a)).

3. Based on *Construction Engineering (Aust) Pty Ltd v Hexyl Pty Ltd* (1985) 155 CLR

541 at pp 544-545; (1985) 59 ALJR 393 at pp 395-396, discussed by Cameron, I, *Letting sleeping partners lie: Construction Engineering (Aust) Pty Ltd v Hexyl Pty Ltd* (1987) 15 ABLR 5.

4. [1962] 3 All ER 1103.

The active partner in a partnership of three produce merchants who entered a joint venture with a third party for the purchase and resale of a cargo of potatoes bound the firm because buying and selling potatoes was part of the firm's business of produce merchants and the joint venture was managed by the firm. The joint venture involving the potatoes was not "another business".

— *Mann v D'Arcy*⁵ —

Other examples of "business of the kind carried on by the firm" include:

- one partner signing a proposal form for partnership insurance. Because the partner signs the form on behalf of all partners as their agent, that partner's answers bind all the partners.⁶
- A partner can bring legal proceedings in the name of the partnership — for example in contract where partnership liability is joint (§10-250) — on behalf of the firm because every partner is an agent of the firm. All the partners are parties to the legal action (§10-260).⁷

In contrast, a partner entering into a joint venture with a third party would not bind the firm to the joint venture.⁸

Managing partner. There is no technical definition of a "managing partner". As the authority of a managing partner varies from firm to firm, it only covers the matters given by the agency.⁹

(2) "*In the usual way*". Even if the action by the partner is within the scope of the business carried on by the firm, if it is carried out in an unusual manner the other partners may not be bound. This is because the unusualness of the method may be enough to put the third party on notice that the partner really may not have authority to bind the other members of the firm.

— *Case example* —

A partner borrowing on behalf of the firm at over 60% interest (when normal rates at the time were between 6% and 10%) was held to be beyond "the usual way" and the firm was not bound.

— *Goldberg v Jenkins*¹⁰ —

(3) *Third person's knowledge and belief.* The final test before the section can operate concerns the knowledge and belief of the third party. If it knows that the partner has no authority to commit the firm to the transaction in question, or if it does not believe him to be a partner, clearly the third party cannot take action against the other partners.

5. [1968] 1 WLR 893.

6. An insurer could disclaim, on the grounds of non-disclosure, liability to an innocent partner effecting insurance who was unaware of or who could not disclose fraudulent conduct by the other partner: *Yorkville Nominees Pty Ltd (in liq) v Lissenden* (1986) 160 CLR 475; ¶17-450.

7. *Kapeleris v Bytenet Pty Ltd* (1997) 15 ACLC 1,308.

8. *Rowella Pty Ltd v Hoult* [1988] 2 Qd R 80.

9. *Re ACN 072 081 111 Pty Ltd; ex parte Merrett* (1997) 15 ACLC 1,494.

10. (1889) 15 VLR 36.

The section also restates the law of the undisclosed principal, to the effect that if the factors set out at ¶11-340 are satisfied, partner B (as undisclosed principal) will be bound by the actions of partner A only if A had actual or ostensible authority to contract on behalf of A and B.

¶10-230 Partners bound by acts on behalf of firm. The following section makes clear that an act done with the intention of committing the firm will commit the firm:¹¹

“... An act or instrument relating to the business of the firm and done or executed in the firm-name or in any other manner showing an intention to bind the firm by any person thereto authorized whether a partner or not is binding on the firm and all the partners.

This section shall not affect any general rule of law relating to the execution of deeds or negotiable instruments.”

Likewise, any authorised document in the firm’s name will bind the firm. Note also that when partners are sued, the action may be in the firm name: see ¶10-260.

When partners will not be bound. The other side of this section provides that any act done or document signed, even if related to the business and done for its benefit, will not commit the firm if done by a person in that person’s own right and not on behalf of the firm. Did the party act privately or for the firm? If an agent/partner contracts as principal, that agent/partner is personally responsible. In reality this means that all the partners need do to avoid a transaction that they did not agree to enter would be to show that it was entered into not on their behalf but by a person as principal in that person’s own right.

The Act in other sections reinforces the above proposition. For example, the firm is not bound where one partner pledges the credit of the firm for a purpose apparently not connected with the firm’s ordinary course of business; and the position is clarified regarding restrictions on the powers of the partners:

“Partner using credit of firm for private purposes

Where one partner pledges the credit of the firm for a purpose apparently not connected with the firm’s ordinary course of business the firm is not bound unless he is in fact specially authorized by the other partners, but this section does not affect any personal liability incurred by an individual partner.”¹²

“Effect of notice that firm will not be bound by acts of partner

If it has been agreed between the partners that any restriction shall be placed on the power of any one or more of them to bind the firm no act done in contravention of the agreement is binding on the firm with respect to persons having notice of the agreement.”¹³

11. Vic sec 10; NSW sec 6; Qld sec 9; SA sec 6; Tas sec 11; WA sec 13; ACT sec 10.

12. Vic sec 11; NSW sec 7; Qld sec 10; SA sec 7; Tas sec 12; WA sec 14; ACT sec 11.

13. Vic sec 12; NSW sec 8; Qld sec 11; SA sec 8; Tas sec 13; WA sec 15; ACT sec 12.

This section confirms the rule of agency law that a principal cannot end the power of its agent to deal with third parties on behalf of the principal unless the third party is notified of the restriction. Therefore any internally agreed restriction on the authority of a partner will not bind third parties who do not know of it.

¶10-235 Implied or usual authority of partners. As a result of case decisions over the years, a partner normally has the implied authority or power within the agency section of the Act to do all things necessary to carry on in the usual way the business of the kind carried on by the firm (¶10-210; ¶11-120):

- (1) In the case of an ordinary trading or commercial partnership, this includes the power to pledge or sell the partnership property; the power to buy goods on account of the firm; the power to borrow money, contract debts, and pay debts, and the power to draw, make, sign, indorse, accept, transfer, negotiate, and procure to be discounted, promissory notes, bills of exchange, cheques and other negotiable instruments in the name of and on account of the firm.¹⁴
- (2) Implied authority in a non-trading partnership is normally restricted by the nature of the firm, but it may include some or all of the above powers. However, at the very least it is accepted to include the power to buy and to sell trading stock, the power to receive payment of debts due to the firm and to give binding receipts, and the power to hire and fire staff on account of the firm.

To bind the firm, a partner signing for the partnership can sign in the partner's name or in the firm's name.

In contrast, there are certain powers not normally held by partners. For example, partners do not normally have the power to bind the firm (without the agreement of all the partners) to legal proceedings in their own name on behalf of the firm;¹⁵ to open a partnership bank account in their own name; to increase the capital of the firm; to bind the firm by deed; to settle debts; to extend the business of the firm into new areas; to make the partners into partners with other persons; to bind the firm to a guarantee; or to mortgage partnership property.

Partners can agree to restrictions on the power of individual partners to bind the firm, but these restrictions will not bind a third party unaware of the restriction as in the *Mercantile Credit case* (¶10-210).

14. *Bank of Australasia v Breillat* (1847) 6 Moo PC 152 at pp 193-194; 13 ER 642 at pp 657-658, citing Story's *Treatise on Partnership*. In this case, the Privy Council held that the managing partners of the then Bank of Australia had the power to borrow with a promissory note (¶16-615) (from the Bank of Australasia) for the purpose of discharging the existing

liabilities of the bank. The bank was established as a partnership in Sydney in 1823, and the partnership was sued in contract through Breillat (its Chairman) as a nominal defendant.

15. *Re Sutherland & Partners' Appeal* [1994] Simon's Tax Cases 387 (English Court of Appeal).

¶10-240 Liability of partners in contract, tort and crime: general considerations.

In summary the position is this:

- Each partner is *jointly* liable for any *contract* incurred by or on behalf of the firm. Joint liability means that although liability is incurred by two or more persons, there is only one right of action against them. (See ¶10-250—¶10-260.)
- Each partner is *jointly and severally* liable for any *tort* committed by the firm. Joint and several liability means that liability is both “joint” (as above: shared) and “several”, ie individual (¶10-270—¶10-280).¹⁶ In the words of the Full Federal Court:¹⁷ “The fact that an obligation is several as well as joint does not expose each promisor to a different or higher measure of liability. It simply confers on the promisee the procedural advantage of seeking recourse, if necessary, against each promisor until the total liability has been satisfied.
- A partner may be liable in crime with co-partners. (See ¶10-290.)

Partnership liability for partners who are directors. Should partners of a person who is a director of a company be responsible for liability incurred by their partner as a director? There are two views:

- (1) Yes: taking on a directorship may be in the course of a partnership’s business within the agency section (¶10-210) and therefore the other partners would be jointly liable for the actions and liabilities of their partner.¹⁸ The directorship would normally require approval by the other partners to ensure that it was in line with the business of the firm, and the partner/director would account to the firm for income derived as a director.
- (2) No: appointment as a director is a personal appointment of the partner as an individual, not as a partner. Directors owe non-delegable fiduciary duties to the company (¶9-480). The firm is not in the business of providing directors, and the other partners should not be liable for the actions of the director/partner unless clearly agreed.¹⁹

¶10-250 Liability of partners in contract.

Where a firm incurs a debt or obligation by way of contract — in other words the agency

16. cf joint and several liability of supplier and credit provider in consumer credit (¶14-210) and of indorser and drawer of a cheque (¶16-340—¶16-350) and under the *Trade Practices Act 1974* (Cth): ¶8-840. The *Inquiry into the Law of Joint and Several Liability* (the Davis Report), 1995, recommended replacing the joint and several liability of defendants in negligence actions with liability proportionate to their responsibility (proportionate liability): ¶4-290).

17. *Amadio Pty Ltd v Henderson* (1998) 81 FCR 149 at p 212; ¶10-060.

18. Compare *Kelly v Murphy* (1993) 11 ACLC 1,230 (NSW Court of Appeal).

19. The *Partnership Act 1892* (NSW), amended in 1998 with the addition of sec 10(2), now provides that a firm is not liable for the wrongful acts or omissions of a partner committed as a director of a company.

requirements of ¶10-210 are fulfilled and there is no defence under sec 12 (Vic) or equivalents (see ¶10-230) — all partners will be liable under it. This means that all members of the firm are responsible for contracts which are validly binding on the firm.

The section headed “Liability of partners”²⁰ is one of the most important sections of the Act. Its consequences are far-reaching:

“... Every partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner, and after his death his estate is also severally liable in a due course of administration for such debts and obligations so far as they remain unsatisfied but subject to the prior payment of his separate debts.”

The partners’ liability in contract is “joint” — this means that the partners must be sued together in only one legal action. If only some of the partners are sued and found liable for the partnership contract, the other partners cannot be sued later because the judgment against the partners discharges the other partners from liability.

This common law restriction has been reversed by some legislation:

- (1) under the Rules of Court, action may be taken against the partners in the name of the firm, and if there is judgment against the firm, it is effectively judgment against each of the partners (¶10-260), and
- (2) the bar on further proceedings has been removed in some jurisdictions so that joint liability becomes individual or “several” when judgment is obtained.²¹

¶10-260 Suing in the firm name. A partnership is not a separate legal entity like a company (¶9-270) and therefore cannot sue and be sued as a legal person. To overcome this, the Rules of Court in each jurisdiction now state that a partnership can be sued in the firm name (“X and Associates”) and judgment will bind all the partners. Without this, all partners would have had to be sued in their own names (“X, Y and Z trading as X and Associates”) for their joint liability in contract (¶10-250), and for their joint and several liability in tort (¶10-270) and for misapplication (¶10-330).

If partners incur legal liability, they can be sued in the name of the firm of which they were partners even if the firm no longer exists at the time the actual loss or damage arises (and therefore they are no longer partners of the defunct firm).²²

¶10-270 Liability of partners for wrongs. The Act provides that the firm is liable for wrongs of partners committed in the ordinary

20. Vic sec 13; NSW sec 9; Qld sec 12; SA sec 9; Tas sec 14; WA sec 16; ACT sec 13.

21. eg under the *Supreme Court Act 1970* (NSW) sec 97, a joint debtor can be sued individually (severally) even though

judgment has been obtained against the other joint debtor.

22. *State of South Australia v Peat Marwick Mitchell & Co* (1997) 24 ACSR 231.

course of the firm's business. The section is headed "Liability of the firm for wrongs":²³

"... Where by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm or with the authority of his co-partners loss or injury is caused to any person not being a partner in the firm or any penalty is incurred the firm is liable therefor to the same extent as the partner so acting or omitting to act."

The wrongs to which the section applies include civil liability (for example, in tort and for breach of equitable duty (¶1-010)) and also criminal liability (¶10-290).

When the firm is liable, each partner is, as noted above (¶10-240), liable jointly (together) and severally (separately) for the wrong.

The Act provides that the liability of partners for torts (and for misapplication: ¶10-330) is joint and several:²⁴

"... Every partner is liable jointly with his co-partners and also severally for everything for which the firm while he is a partner therein becomes liable under either of the last two preceding sections."

For this section to be satisfied, however, there are certain requirements:

- the wrongful conduct of the errant partner must be in the ordinary course of the business of the firm, or
- it must be committed with the authority of the co-partners.

Where the section applies, the innocent partners may be entitled to indemnity from the guilty partner unless they themselves were involved in the wrong.

— Case examples —

Accountants. An accountant (C) deposited two cheques belonging to client B in his partnership trust account. The first cheque was drawn in favour of B or bearer and was crossed Not Negotiable; the second cheque was drawn payable to B or order and was crossed Not Negotiable Account Payee (¶16-250ff). The accountant deposited both cheques in the firm's trust account (having indorsed the order cheque: ¶16-280), the bank collected payment of both cheques and the accountant withdrew the proceeds for his own use. The collecting bank was held liable to B (the true owner of the cheques) in the tort of conversion (¶4-020) as the defence under the *Cheques Act 1986* sec 95 was not available to it (¶16-540). The High Court dismissed action by the bank against the innocent partner of C for an indemnity on the basis that the fraud of the accountant was not a transaction in the ordinary course of the firm's business or a transaction carried out with the authority

23. Vic sec 14; NSW sec 10(1); Qld sec 13; SA sec 10; Tas sec 15; WA sec 17; ACT sec 14. The joint and several liability of partners in tort does not operate in reverse. An uninjured partner cannot claim damages for economic loss from a third party for

negligently inflicting personal injuries on another partner: *Rolton v Dalgety Farmers Ltd* (1992) 58 SASR 581.

24. Vic sec 16; NSW sec 12; Qld sec 15; SA sec 12; Tas sec 17; WA sec 19; ACT sec 16.

of his partner. The facts that the cheques were payable to a third party, of which the accountant was a director, and that the cheques were substantial in amount compared with those previously deposited in the trust account, were considered by the majority of the High Court as going towards taking the accountant's actions outside the ordinary course of the firm's business and outside his apparent authority.

The bank's claim in the alternative that the moneys credited to the trust account were moneys had and received by the partnership was also dismissed. The innocent partner of C could not be liable because the moneys were not deposited with authority or in the ordinary course of the firm's business and were never received by the partnership (or the partner). The partner did not know of the moneys in the trust account and the evidence did not disclose that he ought to have known of them.

*National Commercial Banking Corporation
of Australia Ltd v Batty*²⁵ —

Vehicle repairers. The two defendants carried on a motor vehicle repair business in partnership. Good-humoured horseplay in the workshop led to D1 spilling inflammable paint thinner on the plaintiff employee (P) which accidentally caught fire, severely burning P. The innocent partner (D2) appealed against judgment in P's favour of \$325,000 for burns and other injuries (satisfied in part by workers' compensation). D2 claimed that D1's conduct was a "frolic of his own" as understood in employer/employee law for which D2 could not be held responsible because it was neither within the purposes of the partnership under the agency section (¶10-210) nor within the ordinary course of the business of the firm. However, the New South Wales Court of Appeal held that D1's conduct was "part of the authority and the duties of a partner", which include the duties of the partners as employers to their employees. One of the duties of an employer is to take precautions for the safety of employees (¶4-090). D1's liability was the liability of the employer in the discharge of its duty to the employee, and as D1 was in breach of this duty, D2 as his partner was also liable.

*Petrou v Hatzigeorgiou*²⁶ —

Chartered accountants. The business of a partnership of three chartered accountants consisted primarily of conducting receiverships (through X), conducting liquidations (through D1) and taxation and secretarial services (through D2). The partnership was dissolved when D1 discovered that X had fraudulently misappropriated property of P to the value of some \$220,000 over a five-month period. X was then charged, convicted, jailed for fraud (ie theft or a related offence: ¶2-330) and made bankrupt. P later successfully sued innocent partners D1 and D2 in the tort of deceit (under NSW sec 10) for compensation for its loss following X's misappropriation (sec 11(a) could also have applied: ¶10-330). D1 and D2 unsuccessfully raised three defences to liability: (1) that X, when he committed the wrongful acts, was not "acting in the ordinary course of the business of the firm" as his receivership practice was not the business of the firm: rejected, as his fee income went to the

25. (1986) 160 CLR 251; noted LSJ, Vol 24, No 11, p 26 (December 1986); Australian Accountant, Vol 57, No 1, p 60 (February 1987).

26. (1991) Aust Torts Reports ¶81-071.

partnership; (2) that X's appointments as receiver were personal to him since D1 and D2 were not qualified receivers: also rejected, as fee income went to the firm; (3) that when acting as a receiver, X was not acting as an agent of the firm because he was appointed as an individual: rejected, as the business of the firm by agreement between partners included receiverships, liquidations and taxation and secretarial services.

*Walker v European Electronics Pty Ltd (in liq)*²⁷ —

A conspired with B and B's solicitor C to steal \$US50m from P by a series of sham contracts. C's partners, although innocent of any personal wrongdoing, were held vicariously liable to P under this section of the *Partnership Act* for the losses caused by C. C's partners settled with P for \$US10m, and then claimed contribution from A and B. The defence of A and B — that the partners were not liable because C's liability was not a liability in tort but in constructive trust (¶9-755) to which the *Partnership Act* did not apply — was unsuccessful. The court held that the section did apply to a liability to pay damages in equity based on fault as it uses the words "Where by any wrongful act or omission ... loss or injury is caused ...".

*Dubai Aluminium Company Ltd v Salaam*²⁸ —

Mechanics. An award of damages for sexual harassment of employees was made against D1 and D2, who were partners in the firm A & A Motors, for offending conduct by D1. The court held that where sexual harassment occurs within the ordinary course of the firm's business, all the partners of the firm are liable under NSW and SA sec 5 and equivalents (¶10-210). Therefore the *Partnership Act* imposed vicarious liability under NSW and SA sec 10 and equivalents on all the partners for the wrongful acts or omission of the offending partner.

*Proceedings Commissioner v Hatem*²⁹ —

¶10-280 Liability in tort: firm's benefit or individual partner's benefit? One argument no longer accepted is that the firm cannot be liable unless the act in question was done for the firm's benefit — in other words, fraud or other dishonest conduct carried out for the individual's benefit could not bind the firm. This view was rejected in *Lloyd v Grace, Smith & Co*,³⁰ where a firm of solicitors was held liable for the misappropriation of mortgage moneys by its managing clerk, who had induced one of the firm's clients to transfer the mortgage to him by fraudulently misrepresenting the true nature of the transaction.

The leading Australian case is *Polkinghorne v Holland*:

— *Case example* —

The question was whether two innocent partners in a firm of three solicitors were liable for any part of the loss suffered by a client in consequence of

27. (1990) 23 NSWLR 1, noted eg LSJ, Vol 30, No 3, p 77 (April 1992).

28. [1998] TLR 543, noted (1999) 73 ALJ 109.

29. [1999] 1 NZLR 305, noted (1999) 73 ALJ 333.

30. [1912] AC 716; [1911-13] All ER Rep 51.

the conduct of the third partner, X. When the client, Mrs P, began selling blue chip securities, X advised her to invest in mortgages in which he had a personal interest, such as by advancing money to a company in which X was involved. The company in question had no bank account, no share capital and did no business. The money was not seen again (nor was the company nor X), and Mrs P's action against the innocent partners was successful.

A second important transaction in this case concerned a guarantee for £5,000 (in 1928) which Mrs P signed on X's advice (¶13-360). The guarantee was for an overdraft on behalf of another company with which X was associated. Again, X's scheme failed, and Mrs P was forced to honour the guarantee. The fact that the innocent partners were not liable to indemnify her for this liability indicates the operation of sec 10 (NSW and SA and equivalents). Because she was held to have dealt with X in the guarantee transaction as an individual and to the exclusion of the firm, it was found that the innocent partners could not be forced to reimburse her for her losses on the guarantee. This was separate from the question whether investment advice may have been outside the ordinary scope of a solicitor's business. In any case, the court noted that whether or not investment advice is outside a solicitor's ordinary scope, if a solicitor (as a member of a firm) were consulted by a client on such a matter, the solicitor's duty would require him at least to give an honest answer. After *Hedley Byrne & Co Ltd v Heller and Partners Ltd* (¶4-240) and the *Trade Practices Act 1974* (Cth) sec 52 (¶7-250ff) and sec 74 (¶7-095), and the resulting advent of a strict duty on the part of professional advisers, the words of the High Court on this point in 1934 have been confirmed.

*Polkinghorne v Holland*³¹ —

¶10-290 Liability of partners for crimes. In theory the section headed "Liability of the firm for wrongs"³² can impose joint and several liability on a partner for any criminal act committed by another partner in the ordinary course of business of the firm with the authority of the partners. The section covers "wrongful acts" and speaks of the liability of the firm for "any penalty ... incurred".

A partner's authority would not normally extend to carrying out criminal acts and, except in strict liability offences where proof of a guilty mind (*mens rea*) is not relevant, the courts have read down this section by holding that a partner will not be held liable for the criminal activities of another partner.

— *Case example* —

Chung Brothers, a partnership, contravened legislation regulating trading hours (now repealed) which prohibited the occupiers of a factory having people working in their factory after 2.30 pm on a Saturday. A conviction in the name of the firm would have given "juristic" or legal entity status

31. (1934) 51 CLR 143.

32. Vic sec 14; NSW sec 10; Qld sec 13; SA sec 10; Tas sec 15; WA sec 17; ACT sec 14.

to the partnership. The case was sent back to the magistrate for conviction of the persons shown by the evidence to be members of the firm at the time of the offence. The firm itself cannot be liable for crime, as a partnership is not a separate legal entity.

— *Bishop v Chung Brothers*³³ —

The liability of partners in crime can be summarised as follows:

- Members of a firm could face criminal liability in various situations. For example, if a partnership has illegal purposes, the partners will be liable for criminal prosecution and the partnership itself will be illegal. However, where an individual partner commits a crime, that partner will be liable for prosecution individually rather than in the name of the firm.³⁴
- A partner may be vicariously liable for criminal conduct of a partner in offences which involve, for example, “causing” or “permitting” certain conduct.
- A partner may face criminal liability as an accessory to a crime.

¶10-330 Liability for misapplication of money or property.

The section headed “Misapplication of money or property”³⁵ makes the point that money or property misapplied by a partner must be made good by the firm:

“In the following cases, namely:

- (a) Where one partner acting within the scope of his apparent authority receives the money or property of a third person and misapplies it; and
- (b) Where a firm in the course of its business receives money or property of a third person and the money or property so received is misapplied by one or more of the partners while it is in the custody of the firm—

the firm is liable to make good the loss.”

Liability for misapplication is joint and several, like liability in tort (¶10-270).

This section imposes liability on the firm in two different situations. In each situation, the misapplication must be in the course of the business of the firm, so liability of the firm must first be established under the agency section discussed at ¶10-210. The section cannot apply where the partner receives money or property privately and not as a partner of the firm.

33. (1907) 4 CLR 1262.

34. eg Corporations Law sec 1002N provides a “Chinese wall” defence to the innocent partners of a partner charged with insider trading.

35. Vic sec 15; NSW sec 11; Qld sec 14; SA sec 11; Tas sec 16; WA sec 18; ACT

sec 15. It was recognised in *Walker v European Electronics Pty Ltd (in liq)* (¶10-270) that if NSW sec 10 applied, there would be no reason to give independent consideration to sec 11.

- Under para (a) of the section, the firm was held liable in the following case:

— *Case example* —

R, a partner in a firm of solicitors, received investment moneys from Mr and Mrs H for the purpose of investments by second mortgages with other clients of the firm engaged in the building trade. R assured them that their investment would be safe and gave his personal promissory note as extra security. The moneys so advanced were misapplied by R, and Mr and Mrs H successfully claimed that the firm was liable for the amounts misapplied plus interest. Liability was clear under para (a) because it was found that R was clearly acting within the scope of his apparent authority as a partner in a firm of solicitors. It was further held that the true nature of the transaction was not changed by the use of the promissory note, and accordingly the innocent partners were held liable under the equivalent of sec 15 (Vic) for the amount misapplied.

— *Mann v Hulme*³⁶ —

- Under para (a) of the section, the firm will not be liable if the partner misapplies money or property in a transaction not within the partner's apparent authority or not connected with the business of the firm.
- Under para (b), the firm is responsible if money or property of a third person is misapplied without authority while in the custody of the firm.
- Under para (b), the firm is not liable for fraud by one partner acting on that partner's own account.

Misapplication of trust property. The next section expands the principle to cover misapplication of trust property. It is headed "Improper employment of trust property for partnership purposes".³⁷

"If a partner being a trustee improperly employs trust-property in the business or on the account of the partnership no other partner is liable for the trust-property to the persons beneficially interested therein:

Provided as follows:

- (1) This section shall not affect any liability incurred by any partner by reason of his having notice of a breach of trust; and
- (2) Nothing in this section shall prevent trust-money from being followed and recovered from the firm if still in its possession or under its control."

This section provides that where a partner who is a trustee breaches the trust (¶9-880) by using trust property for partnership business, the beneficiaries cannot sue the innocent partners for that partner's breach of trust unless one of the following provisos is fulfilled:

36. (1961) 106 CLR 136; similarly, *National Commercial Banking Corporation of Australia Ltd v Batty* (1986) 160 CLR 251; (1986) Aust Torts Reports ¶80-013; discussed at ¶10-270.

37. Vic sec 17; NSW sec 13; Qld sec 16; SA sec 13; Tas sec 18; WA sec 20; ACT sec 17.

Under proviso (1), the innocent partners can be sued by the beneficiaries if implicated in the breach of trust. For example, if the innocent partners know that trust moneys are being used in the partnership business, or that they are otherwise being misused in breach of trust, they may be liable to the beneficiaries.

Proviso (2) confirms that a beneficiary can track or “trace” its own money if the money is still in the possession of the firm³⁸ whether or not the firm has notice of or is implicated in the breach of trust, because the beneficiary is still the owner of its own money.

¶10-340 Partnership by estoppel. The *Partnership Act* makes it clear that a partner in a firm can be liable for a wide range of activity in many areas of legal liability — contract, tort, crime, trusts. The persons liable are the actual partners themselves, and persons who may not have been formally admitted as partners but who have been held out to the world to be partners. This is an application of the rule of evidence known as “estoppel”. Estoppel means that if any person either expressly or by conduct represents to another person that a certain state of facts exists, and the other person acts upon that representation and incurs loss or damage, then the representor cannot deny the truth of the representation. (In the banking context, see ¶16-480 — estoppel of customer.)

The *Partnership Act* puts it thus, in the section headed “Persons liable by ‘holding out’ ”:³⁹

“... (1) Every one who by words spoken or written or by conduct represents himself or who knowingly suffers himself to be represented as a partner in a particular firm is liable as a partner to any one who has on the faith of any such representation given credit to the firm whether the representation has or has not been made or communicated to the person so giving credit by or with the knowledge of the apparent partner making the representation or suffering it to be made.

(2) Where after a partner’s death the partnership business is continued in the old firm-name the continued use of that name or of the deceased partner’s name as part thereof shall not of itself make his executors or administrators estate or effects liable for any partnership debts contracted after his death.”

If there is evidence that a person has consented to having been held out as a partner, that person can be sued as a partner if the following three tests are fulfilled:

- (1) There must be a representation that the person in question is a partner. It can be by the person in question, or by anyone else (in most cases, the other partners). It can be by act or by word. Registration of a person who is not a partner as a partner under the *Business Names Act*

38. The beneficiaries cannot recover trust moneys from a bona fide purchaser for value without notice (¶13-270).

39. Vic sec 18; NSW sec 14; Qld sec 17; SA sec 14; Tas sec 19; WA sec 21; ACT sec 18.

is not a “representation” unless that person authorised the registration, ie “knowingly suffered himself”.⁴⁰

- (2) Credit must have been given to the firm on the faith of the representation.

— *Case example* —

Williamson, who practised as a solicitor under the name of “John Williamson & Sons” had two employee solicitors, D1 and D2, whose names appeared on the letterhead as partners. P had always dealt with D2 for legal advice. P invested some money with Williamson, who misappropriated it, so P sued D1 and D2 for compensation on the basis that they had been held out as Williamson’s partners. P failed against D1, as P’s decision to invest was not influenced by whether or not D1 was a partner. P succeeded against D2, as P’s decision was influenced by P’s understanding that D2 was a partner. In the words of the High Court:

“The doctrine of holding out is a branch of the law of estoppel. So far as the element of action by the party relying upon an estoppel is concerned, it is sufficient if that party acts to his prejudice upon a representation made with the intention that it should be so acted upon, though it is not proved that in the absence of the representation he would not have so acted.

In the present case it is proved that [D2] held himself out and suffered himself to be represented as being a partner in a firm of John Williamson & Sons. The heading of the letter paper is conclusive upon this point. Secondly, it is proved that [P] gave credit to the ‘firm’ in that he entrusted the ‘firm’ with his money for purposes of investment. In the third place there is evidence that he so gave credit because he believed that [D2], whom he trusted, was a partner.”

— *Lynch v Stiff*⁴¹ —

- (3) Reliance on the representation. For the section to operate, the person relying on the representation must show that he did in fact rely on the representation. Whether it was true or false is not the point so long as the person relying on it believed it to be true. Entrusting money to the firm in reliance on the belief that X is a partner is the gist of the section.

There are a number of important examples of the operation of this section.

— *Case example* —

After dissolution of the partnership of A and B, which had carried on business as a furniture retailer, former partner A placed an order for six bedroom suites with furniture supplier P, on the old firm’s letterhead, without the knowledge and the authority of B. When the order was not paid for, P was unsuccessful in its claim against B because the former partner had not “knowingly” allowed himself to be represented as a partner, and in any case, the suppliers had not known him to be a partner before the dissolution of the firm (hence he was saved from liability under

40. cf position of companies: *Royal British Bank v Turquand* (1856) 6 E & B 327; 119 ER 886, noted at ¶9-470.

41. (1943) 68 CLR 428, at p 435; similarly, *Nationwide Building Society v Lewis* [1997] 3 All ER 498; salaried partners: ¶10-160.

the equivalent of NSW and SA sec 36(3) even though he was an apparent member of the old firm under sec 36(1)) (¶10-550). A's order was also in breach of the dissolution agreement between A and B.

_____ *Tower Cabinet Co Ltd v Ingram*⁴² _____

This case raises the important question of the precautions to be taken by retiring partners to ensure that their name is not used in vain. Whether it is their duty to take an active role to see that it is not is considered below (¶10-360).

In contrast, if there are continuing indicia of partnership upon which a creditor could rely for apparent authority even after an agreement between partners to dissolve the firm, such as the firm's listing in the phone book, the response of the receptionist answering the phone and the firm's stationery, "a partner who makes, and consents to, continued representations that a partnership in fact exists is estopped to deny ... [partnership] to defeat the claim of a creditor". In such circumstances, a plaintiff bank succeeded in enforcing payment of a loan from the borrower's partners despite an as yet private agreement of the partners to dissolve the firm.⁴³

¶10-350 Admissions and representations of partners. The section headed "Admissions and representations of partners"⁴⁴ makes clear the essential mutual agency nature of partnership when it says that—

"An admission or representation made by any partner concerning the partnership affairs and in the ordinary course of its business is evidence against the firm."

Again with "the ordinary course of business" as the test, as noted in ¶10-210, the firm will be held responsible for statements of a partner when made within the partner's actual or apparent authority. On ordinary principles of estoppel, the co-partners would be estopped from denying the truth of the statements made.

Under the section headed, "Notice to acting partner to be notice to the firm",⁴⁵ notice given to an acting (meaning active as opposed to dormant) partner is equivalent to a notice given to the firm:

"Notice to any partner who habitually acts in the partnership business of any matter relating to partnership affairs operates as notice to the firm except in the case of a fraud on the firm committed by or with the consent of that partner."

This section confirms that innocent partners are not presumed to know of fraud being carried out by one of their partners. This is reinforced by the fact that a fraudulent partner will normally wish to keep fraudulent activities secret.¹

42. [1949] 2 KB 397; [1949] 1 All ER 1033.

43. *Royal Bank and Trust Co v Weintraub, Gold & Alper* 506 NYS 2d 151 (1986).

44. Vic sec 19; NSW sec 15; Qld sec 18; SA sec 15; Tas sec 20; WA sec 22; ACT sec 19.

45. Vic sec 20; NSW sec 16; Qld sec 19; SA sec 16; Tas sec 21; WA sec 23; ACT sec 20.

1. *Switzerland Insurance Australia Ltd v McCann* [1999] NSWCA 310 at [43].

Knowledge of the firm. A person dealing with a firm deals with the whole firm, and the knowledge of one partner is to be imputed as the knowledge of the others.²

This is obvious in the light of ordinary agency principles. What is more difficult, however, is the status of notice to persons in more unusual situations:

- Notice to a dormant partner must be notice to the firm under agency law.
- Notice to a person before the person forms the firm is not considered notice to the firm.³
- Knowledge by one partner of a fraud (actual or imputed) is not the knowledge of the firm.⁴

¶10-360 Liabilities of incoming and outgoing partners.

Liabilities facing a partner are significant, as this Division of the *Partnership Act* shows. The section headed “Liabilities of incoming and outgoing partners”⁵ helps to limit those liabilities to a finite period:

“(1) A person who is admitted as a partner into an existing firm does not thereby become liable to the creditors of the firm for anything done before he became a partner.

(2) A partner who retires from a firm does not thereby cease to be liable for partnership debts or obligations incurred before his retirement.

(3) A retiring partner may be discharged from any existing liabilities by an agreement to that effect between himself and the members of the firm as newly constituted and the creditors and this agreement may be either express or inferred as a fact from the course of dealing between the creditors and the firm as newly constituted.”

Essentially, a partner is only liable for partnership liabilities incurred while a member of the firm. In other words, and really as a matter of common sense, the partner is not liable for what happened before becoming a partner or what happened after retiring from the firm. To avoid the possibility of liability for future debts of the continuing firm, an outgoing partner should give actual notice to existing third parties such as clients. To avoid liability to future third parties, an outgoing partner should give public notification of retirement in the *Government Gazette*, etc: ¶10-550.

Novation agreement. Subsection (3) provides that a retiring partner’s liability can be discharged by an agreement to that effect between the retiring partner, the members of the firm, and the creditors. Such an agreement is called a novation; in other words, a substitution of a new contractual liability in consideration of a release from an existing contract. Novation may be express or implied, and case law shows that where creditors continue to deal with a

2. *Mallesons Stephen Jaques v KPMG Peat Marwick* (1990) 4 WAR 357. This principle is set out for the purposes of an insider trading prosecution in the *Corporations Law* (sec 1002F).

3. *Williamson v Barbour* (1877) 9 Ch D 529.

4. *Ibid*, cited in *Yorkville Nominees Pty Ltd (in liq) v Lissenden* (1986) 160 CLR 475 at p 483; (1986) 4 ANZ Insurance Cases ¶60-692 at p 74,120.

5. Vic sec 21; NSW sec 17; Qld sec 20; SA sec 17; Tas sec 22; WA sec 24; ACT sec 21.

firm as newly constituted, following the retirement of a partner, they impliedly agree to accept the new firm as debtors in the place of the old firm.⁶

But the onus remains on the retired party to prove an express or implied discharge from liability. The retired partner must prove discharge by novation or by separate agreement with the creditor, and just relying on the fact of retirement may prove costly unless the retired partner has taken the precautions required by the section. If the creditors refuse to accept a novation (eg refuse to accept an impecunious substitute partner for a wealthy retiring partner), the retiring partner cannot force them to do so. The creditors could still hold the retired partner liable, and the normal solution would be an agreement upon a partner's retirement whereby the new or continuing partners agree to indemnify the retired partner for any former partnership liabilities.

The succeeding section adds to this principle when it makes clear that if there is a change in the membership of a firm which has entered a continuing guarantee either as guarantor, creditor or principal debtor, the guarantee is revoked.⁷

"Revocation of continuing guaranty by change in firm

A continuing guaranty given either to a firm or to a third person in respect of the transactions of a firm is in the absence of agreement to the contrary revoked as to future transactions by any change in the constitution of the firm to which or of the firm in respect of the transactions of which the guaranty was given."

In other words, in the absence of a contrary agreement, a guarantee (a promise to pay for the debt of another) is revoked by a change in the membership of the firm in whose favour it was given (§13-360).⁸

RELATIONS OF PARTNERS TO ONE ANOTHER —

The fiduciary relationship	¶10-370
Variation by consent of terms of partnership	¶10-380
Partnership property	¶10-390
Property bought with partnership money	¶10-400
Conversion into personal estate of land	
held as partnership property	¶10-410
Procedure against partnership property for	
a partner's separate judgment debt	¶10-420
Management matters settled by the Act	¶10-430
Expulsion of partner	¶10-440
Duty of partners to render accounts, etc	¶10-450
Accountability of partners for private profits	¶10-460
Duty of partner not to compete with firm	¶10-470
Rights of an assignee of a share in the partnership	¶10-480

6. *Rolfe and Bank of Australasia v Flower Salting & Co* (1866) LR 1 PC 27. See also *Thompson v Percival* (1834) 5 B & Ad 925; 110 ER 1033.

7. Vic sec 22; NSW sec 18; Qld sec 21; SA sec 18; Tas sec 23; WA sec 25; ACT sec 22.

8. *Re DK Rogers; Ex parte CMV Parts Distributors Pty Ltd* (1989) 20 FCR 561.

¶10-370 The fiduciary relationship. The 13 sections of the Act grouped under the heading “Relations of partners to one another” set out the principles for internal regulation of the firm. Strictly, this is a matter of agreement between the partners, and the model set of rules provided by these 13 sections can be expressly excluded.

Although the Act leaves the partners considerable freedom in making their own rules, a common practice is for parties to sign one of the ready-made printed partnership forms available for a few cents from legal stationers. Before signing, the partners should check that the form really sets out their true intentions. Certain matters may be overlooked by a formal agreement and by the Act, and ideally these should be clearly stated in writing to avoid friction at a later date. Problem areas often include impractical retirement provisions, discrimination (¶10-020), holidays, unenforceable restraint clauses (¶5-840ff), non-promotion, inequitable dividing of profits, and non-recognition of partners’ needs.

Whatever the agreement says, the basis of partnership is the fiduciary relationship before, during and after partnership (¶10-570) in the defined area to act in the interests of the partners marked by mutual confidence and the duty of the utmost good faith. Outside the defined area, a partner under a fiduciary relationship retains economic liberty (¶10-470).

The duty of good faith as the key to a fiduciary relationship is not expressly defined as a section of the Act but these 13 sections all revolve around this theme, as indeed does the whole Act. In the words of the then *Indian Contract Act 1872*, which codified the English law of the day, the partners were “to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts” and to provide full information on all things affecting the firm to any partner or partner’s legal representative.⁹ (The fiduciary relationship is discussed at ¶9-770, and with reference to agency law at ¶11-180—¶11-190.)

Where the partners purport to exercise a right conferred by their agreement, the court will read down the right if there is any breach of the overriding fiduciary obligation. Revealing the financial problems of the firm may be in breach of the partnership fiduciary obligation of confidentiality.¹⁰

The 13 sections concerning relations between partners are discussed in turn below.

¶10-380 Variation by consent of terms of partnership. The first of the sections which outline the relations between partners simply says:¹¹

9. Compare NSW and SA sec 28-30 and equivalents (¶10-450) where a severely pruned form appears.

10. *Kelly v CA & L Bell Commodities Corporation Pty Ltd* (1989) 18 NSWLR 248.

11. Vic sec 23; NSW sec 19; Qld sec 22; SA sec 19; Tas sec 24; WA sec 29; ACT sec 23.

“The mutual rights and duties of partners whether ascertained by agreement or defined by this Act may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing.”

The section preserves freedom of contract and allows for ready variation in the partnership agreement. Actual authority conferred on partners can be negated or qualified by agreement under this section.¹² It displaces the common law rule that a written contract must be varied by writing and allows for verbal variation of a written partnership agreement. Even if the partnership agreement is under seal, it will be able to be varied by an informal agreement between the partners or by their course of dealing.

— *Case example* —

A partnership agreement provided, amongst other things, for the making out of an annual statement of account of the partnership assets and liabilities (including estimated value of goodwill) which was to be final and conclusive between the partners regarding all matters therein. At no time were accounts prepared strictly in accordance with this clause (eg goodwill was not taken into account, and except on two occasions the accounts were not signed by the partners) and one question which arose in the case was whether this clause of the partnership agreement had been varied by the partners' course of dealing. The High Court acknowledged a long standing precedent that if the usage of the partners is not in strict accordance with the written agreement, that becomes evidence of a new agreement by the partners and becomes as binding as if presented by the written partnership agreement.

— *Public Trustee v Schultz*¹³ —

In other words the section also authorises changes in the partnership practice and a change in the terms of the partnership agreement by a course of dealing. Where this has been agreed to by the partners, it will cause a binding change in the partnership agreement, caused partly by the partners “sliding into” the new arrangement.¹⁴

¶10-390 Partnership property. Partnership property or assets must be used exclusively for the purposes of the partnership, under the duty of good faith, in accordance with the partnership agreement and the Act. Partnership property (the assets of the firm) may vary from day to day and the concept includes everything of monetary value belonging to the firm. Even though each partner is personally liable for the debts and liabilities of the firm, the exact status of all property brought into the firm will be of importance. The Act¹⁵ provides that every partner is entitled to have the property of the partnership applied in payment of the debts and liabilities of the firm and to have the surplus assets after the payment applied in payment of what may be due to the partners.

12. *Construction Engineering (Aust) Pty Ltd v Hexyl Pty Ltd* (1985) 155 CLR 541 at p 545; see ¶10-210.

13. (1964) 111 CLR 482; (1964) 38 ALJR 128.

14. eg *Const v Harris* (1824) T & R 496, at p 523; 37 ER 1191 at p 1201.

15. NSW sec 39 and equivalents. See ¶10-580.

Also, partnership creditors can enforce their claims against partnership property — a partner may want to be able to claim that a car, for example, is personal property and not property of the firm. But in any case, the *Bankruptcy Act 1966* (Cth) (¶13-720) provides for an order of payment of creditors:

“Joint and separate dividends

Where one partner of a firm becomes bankrupt, a creditor to whom the bankrupt is indebted jointly with the other partners of the firm or any of them shall not receive a dividend out of the separate property of the bankrupt until all the separate creditors have received the full amount of their respective debts.” (sec 141.)

“Apportionment of expenses of administration of joint and separate estates

Where joint and separate estates are being administered, the expenses of and incidental to the administration of the estates shall be fairly apportioned by the trustee between the joint and separate estates, having regard to the work done for, and the benefit received by, each estate.” (sec 142.)

The property described by the *Partnership Act* is property which would ordinarily be held to be partnership property. The purpose of the Act is to describe the property in which the partners have rights and to which creditors of the partnership may look in satisfaction of their debts. “The partner’s share in the partnership is not a title to specific property but a right to his proportion of the surplus after the realisation of assets and the payment of debts and liabilities.”¹⁶ A partner has an interest in every asset of the partnership and this interest is an equitable or beneficial interest (¶3-210): normally the partnership has legal title to the partnership property. The assets of the partnership, individually and collectively, are described as “partnership property” in the Act:¹⁷

“(1) All property and rights and interests in property originally brought into the partnership stock or acquired whether by purchase or otherwise on account of the firm or for the purposes and in the course of the partnership business are called in this Act partnership property and must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

(2) The legal estate or interest in any land which belongs to the partnership shall devolve according to the nature and tenure thereof and the general rules of law thereto applicable but in trust so far as necessary for the persons beneficially interested in the land under this section.

(3) Where co-owners of an estate or interest in any land not being itself partnership property are partners as to profits made by the use of that land or estate, and purchase other land or estate out of the profits to be used in like manner, the land or estate so purchased belongs to them in the absence of an agreement to the contrary not as

16. *Canny Gabriel case* (see ¶9-150) as quoted in, eg, *Connell v DFC of T* 96 ATC 4505 at p 4510; Gallagher, R, *Your partnership: what value?* Australian Accountant, Vol 66, No 6, p 62 (July 1996).

17. Vic sec 24; NSW sec 20; Qld sec 23; SA sec 20; Tas sec 25; WA sec 30; ACT sec 24.

partners but as co-owners for the same respective estates and interests as are held by them in the land or estate first mentioned at the date of the purchase.”

Only the Western Australian Act actually defines the nature of a partner's share in the partnership property in words of relevance to all jurisdictions:¹⁸

“*What is a partner's share.* The share of a partner in the partnership property at any time is the proportion of the then existing partnership assets to which he would be entitled if the whole were realized and converted into money, and after all the then existing debts and liabilities of the firm had been discharged.”

Accordingly,

- The fact that property is partnership property means that if a partner has legal title to it, that partner can enforce the title.
- Not all the property of each partner used for the purposes of the partnership business can be said to be brought into the partnership, and, depending on the agreement of the parties, property may remain the separate property of one partner.
- The acts and intention of the parties — and not the operation of the section — determine finally and ultimately the question of whether property owned by a partner becomes partnership property.
- The interest of a partner in a partnership is an equitable chose in action represented by the entitlement of a partner to participate in a surplus on dissolution (§13-040, §13-210). Because the partner's interest is equitable, it is more than a “mere equity”.
- A partner has a present beneficial interest in every asset of the partnership, which takes effect in possession on the dissolution of the partnership. In the case of partnership real estate, this is made clear in subsec (2) above.
- Because a partner has a proprietary interest in the assets of the partnership — usually equitable, but legal if title is retained — a partner has a caveatable interest in land owned by the partnership (§13-280).¹⁹

— Case examples —

No partnership property

The farm. A (the owner of a farming property) entered partnership with B and C under which A, B and C would work the farm in partnership, with A's share of profits and losses being 50%. Although A was “to throw in” 1,600 sheep and some equipment (which by intention did become partnership assets), A had no intention that the farm itself was to become an asset of the firm as it was intended to be later available for his infant son. It was not shown in the books as a partnership asset, and A was not credited for contributing it to the partnership.

— *Harvey v Harvey*²⁰ —

18. *Partnership Act 1895* (WA) sec 33.

19. *Connell v Bond Corporation Pty Ltd* (1992) 8 WAR 352; to the contrary,

Chettle v Brown [1993] 2 Qd R 604, noted (1995) 69 ALJ 240.

20. (1970) 120 CLR 529.

Abalone authority. When A and B entered partnership as fishermen in 1973, A's abalone permit (indorsed on his fishing licence) was not brought into the books of the partnership as it was personal to A (the holder had to be passed fit to dive, etc) and it was therefore not transferable. After the law was changed in 1980 and the permit was converted to a transferable authority (of real value) referable to a particular boat, the partners did not alter its partnership status. By their intention, it did not become partnership property, and even though the partnership paid the annual fees for the abalone authority, there was no presumption that it was "bought on account of the firm" (¶10-400).

*Kelly v Kelly*²¹ —

The capital of a partnership is different from its property or assets. It is the money, land or other property with which the partnership commences business and is represented by a sum fixed by the agreement of the partners. Anything earned over this in the course of business is not capital but profit. The rules for distribution of assets on final settlement of accounts recognise that the capital of a partnership is different from the assets available on dissolution (¶10-630).²²

Upon dissolution, the partners are to share capital equally (under NSW sec 24(1) and equivalents: ¶10-430). However, "the slightest indication of an implied agreement between the partners that their shares of capital should correspond with their contributions to it will suffice to displace that provision that they are entitled to share equally."²³

¶10-400 Property bought with partnership money. According to the third section²⁴ of the group outlining the relations between partners:

"Unless the contrary intention appears property bought with money belonging to the firm is deemed to have been bought on the account of the firm."

This section and the one before provide "rules of thumb" to assist in determining the final division of property of a partnership following dissolution on the retirement of a partner.

The prime issue is whether one can identify individual items of property brought into the firm, and at least two principles are provided by the sections:

- where partnership property is used by persons who are in a partnership situation or appear to be in a partnership situation, that property will belong to the partnership;

21. (1990) 64 ALJR 234, noted (1990) 64 ALJ 440.

22. eg *Lindley & Banks on Partnership*, London, Sweet & Maxwell, 17th ed, 1995, para 17-01; the earlier edition was cited in *Rowella Pty Ltd v Abfam Nominees Pty Ltd* (1989) 168 CLR 301 at p 305.

23. *Popat v Shonchhatra* [1997] 3 All ER 800 at p 805; ¶10-610.

24. Vic sec 25; NSW sec 21; Qld sec 24; SA sec 21; Tas sec 26; WA sec 31; ACT sec 26.

- the onus rests on the partners if they wish to avoid the presumption that property bought with money which belongs to the firm or partnership must be treated as partnership property.

¶10-410 Conversion into personal estate of land held as partnership property. The Act continues:²⁵

“Where land or any interest therein has become partnership property it shall unless the contrary intention appears be treated as between the partners (including the representatives of a deceased partner) as personal estate.”

This section provides assistance in determining how property is to be dealt with on the decease of a partner. It is important to determine whether the property passes directly to the heir of the deceased partner (as does real property) or whether it is shared among the continuing partners. The section provides a statutory application of the equitable doctrine of conversion.

In the absence of an agreement to the contrary, the property becomes partnership property; and on dissolution of the partnership because of death the property itself must be sold and the proceeds divided up among the partners when the creditors have been paid out. Again, in the absence of any agreement to the contrary, this rule will apply notwithstanding the fact that the property that had been purchased by partners out of partnership proceeds is in fact real property.

¶10-420 Procedure against partnership property for a partner's separate judgment debt. Although the partnership is not a separate legal entity, the Act does contain important provisions which are aimed at preventing creditors from taking action which would in effect destroy the viability of the partnership by enabling them to levy judgment against specific items of partnership property. The relevant section²⁶ provides that no writ of execution shall be issued against any partnership property unless judgment has been obtained against the firm itself. Subsection (2) makes clear that the court may charge a partner's interest and share of profits with payment of a judgment debt, and it may also appoint a receiver of that partner's share of profits and of any other money which may be coming to the partner from the partnership. This may be grounds for dissolution of the firm: ¶10-520.

The section states:

“(1) A writ of execution shall not issue against any partnership property except on a judgment against the firm.

(2) The Supreme Court or the county court may on the application of any judgment creditor of a partner make an order charging that partner's interest in the partnership property and profits with payment of the amount of the judgment debt and interest thereon, and may by the same or a subsequent order appoint a receiver of that

25. Vic sec 26; NSW sec 22; Qld sec 25; SA sec 22; Tas sec 27; WA sec 32, 33; ACT sec 27.

26. Vic sec 27; NSW sec 23; Qld sec 26; SA sec 23; Tas sec 28; WA sec 28; ACT sec 28.

partner's share of profits (whether already declared or accruing) and of any other money which may be coming to him in respect of the partnership, and direct all accounts and inquiries and give all other orders and directions which might have been directed or given if the charge had been made in favour of the judgment creditor by the partner, or which the circumstances of the case may require.

(3) The other partner or partners shall be at liberty at any time to redeem the interest charged or in case of a sale being directed to purchase the same."

¶10-430 Management matters settled by the Act. If any differences of opinion arise in the firm which are not provided for already in the partnership agreement, the Act sets out nine important rules relating to the interests and the duties of partners. The section²⁷ states:

"Rules etc of partners when not subject to special agreement etc

The interest of partners in the partnership property and their rights and duties in relation to the partnership shall be determined subject to any agreement express or implied between the partners by the following rules:

- (1) All the partners are entitled to share equally in the capital and profits of the business and must contribute equally towards the losses whether of capital or otherwise sustained by the firm.
- (2) The firm must indemnify every partner in respect of payments made and personal liabilities incurred by him—
 - (a) in the ordinary and proper conduct of the business of the firm; or
 - (b) in or about anything necessarily done for the preservation of the business or property of the firm.
- (3) A partner making for the purpose of the partnership any actual payment or advance beyond the amount of capital which he has agreed to subscribe is entitled to interest at the rate of Seven per centum per annum from the date of the payment or advance.^[28]
- (4) A partner is not entitled before the ascertainment of profits to interest on the capital subscribed by him.
- (5) Every partner may take part in the management of the partnership business.
- (6) No partner shall be entitled to remuneration for acting in the partnership business.
- (7) No person may be introduced as a partner without the consent of all existing partners.
- (8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners but no change may be made in the nature of the partnership business without the consent of all existing partners.
- (9) The partnership books are to be kept at the place of business of the partnership

27. Vic sec 28; NSW sec 24; Qld sec 27; SA sec 24; Tas sec 29; WA sec 34; ACT sec 29.

28. 6% in Qld, Tas and WA.

(or the principal place if there is more than one) and every partner may when he thinks fit have access to and inspect and copy any of them.

- (10) [In the ACT Act] The operation with respect to a firm or a partner in a firm of any provision of this section is subject to any agreement express or implied between the partners in the firm.”

These rules provide for regulation of the rights and interest that partners have in regard to partnership assets or property and the running of the partnership. Partnership equality, even with unequal contributions to capital, can give rise to partnership profit sharing problems. Are some partners more equal than others? How is recognition to be given to the origination of partnership work? While equality of profit sharing develops a unified team, what is there for incentive and a more-than-equal contribution to the firm?

¶10-440 Expulsion of partner. The Act goes on to say that:²⁹

“No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.”

The power to expel any partner by a majority of the partners must be conferred by express agreement, for example for breach of the agreement or for bankruptcy. Without some specific clause in the partnership agreement to this effect, the only way to remove an objectionable partner is to dissolve the partnership (¶10-490) or to induce the partner to retire (¶10-500).

Because expelling a partner involves that partner in losing property rights, the partners’ power to expel must generally be exercised in good faith. An expelled partner may have a right to a fair hearing.

— Case examples —

3 v 2. If the partnership agreement only provides for expulsion of “a partner”, attempted expulsion of two partners by the other three for breach of the partnership agreement will be invalid as in breach of the partnership agreement.

— *Bond v Hale*³⁰ —

8 v 1. A Brisbane law firm consisted of ten partners. Expulsion of one partner and then the almost simultaneous expulsion of another partner by the remaining eight partners was invalid. The first expulsion notice had to be given by the other nine partners because at this time there were still nine other partners.

— *Russell v Clarke*³¹ —

29. Vic sec 29; NSW sec 25; Qld sec 28; SA sec 25; Tas sec 30; WA sec 35; ACT sec 30.

30. (1969) 72 SR (NSW) 201; noted (1970) 44 ALJ 81.

31. [1995] 2 Qd R 310, noted (1998) 72 ALJ 506. Because of the express words of the

partnership agreements in both cases, interpretation legislation which permits words in the singular to include those in the plural “unless the context otherwise requires” did not apply (¶1-490ff).

6 v 2. Six of the partners in a solicitors' firm were concerned about the performance of two partners — partner H and another partner. At a partners' meeting which neither was notified of or invited to attend, the six partners expelled these two partners by a single special resolution, described as a "world first", giving no reasons for the expulsion and no chance to provide any defence. H, who challenged the decision as in breach of the partnership agreement, failed in a claim for damages for "misleading or deceptive" conduct³² on the basis that he was not informed that his future was one of the subjects of the meeting and that in a partnership relationship there is a reasonable expectation of full disclosure. The court also held that there was no breach of the partners' fiduciary duty: there was no failure to disclose material information, as H, if informed of the meeting, would not have attached significance to it. The case is a reminder that the special resolution procedure can ensure that an expellee is always in the minority, and that in Australia (except in Western Australia)³³ the rules of natural justice can be excluded from an expulsion proceeding.

— *Hanlon v Brookes*³⁴ —

The next two sections, "Retirement from partnership at will"³⁵ and "Continuance of partnership on old terms",³⁶ are discussed below at ¶10-500 and ¶10-510.

¶10-450 Duty of partners to render accounts, etc. The tenth section of the 13 concerning the fiduciary relationship states:³⁷

"Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representative."

In addition to not actively misleading each other, partners must make full disclosure to one another on all matters relating to the partnership business.

— *Case example* —

X and Y were in partnership in a woollen manufacturing business. Partner X offered to buy partner Y's share — partner Y was more or less a sleeping partner (¶10-160) — and did not disclose certain partnership assets (money lent on mortgage) to partner Y. Having accepted the offer, partner Y discovered the non-disclosure, realised that the price was too low and sued for misrepresentation. The court upheld the duty of disclosure between partners and the action was settled on payment of £3,550 to partner Y.

— *Law v Law*³⁸ —

32. Brought under sec 11 of the *Fair Trading Act 1985* (Vic) (not under sec 52 of the *Trade Practices Act 1974* (Cth), because the constitutional connections were absent (¶7-220)): ¶7-280.

33. *Partnership Act 1895* (WA) sec 35(2).

34. (1996) ATPR ¶41-523; appeal dismissed (1997) 15 ACLC 1,626, noted (1998) 72 ALJ 506. Two of the partners were expelled, but this case only involved partner H.

35. Vic sec 30; NSW sec 26; Qld sec 29; SA sec 26; Tas sec 31; WA sec 37; ACT sec 31.

36. Vic sec 31; NSW sec 27; Qld sec 30; SA sec 27; Tas sec 32; WA sec 38; ACT sec 32.

37. Vic sec 32; NSW sec 28; Qld sec 31; SA sec 28; Tas sec 33; WA sec 39; ACT sec 33.

38. [1905] 1 Ch 140; [1904-07] All ER Rep 526.

In other words, there is an overriding duty on partners to have the interests of the firm in mind. This means that situations where a partner faces conflict between partnership duty and personal interests (eg sale of the partner's personal property to the firm) need to be either avoided, or handled very carefully, with full disclosure and agreement by the co-partners. As it was put by one judge:

"... If fiduciary relationship means anything I cannot conceive a stronger case of fiduciary relation than that which exists between partners. Their mutual confidence is the life blood of the concern. It is because they trust one another that they are partners in the first instance; it is because they continue to trust one another that the business goes on."³⁹

This gives rise to further important aspects of partnership management:

- A partner is not entitled to receive an exclusive personal advantage from use (or misuse) of partnership property or information.
- A partner must not profit by competing with the firm.

¶10-460 Accountability of partners for private profits. It follows that a partner must account to the firm, and be accountable to the firm, for private profits made without the consent of the co-partners. The relevant section of the Act provides:⁴⁰

"(1) Every partner must account to the firm for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership or from any use by him of the partnership property name or business connexion.

(2) This section applies also to transactions undertaken after a partnership has been dissolved by the death of a partner and before the affairs thereof have been completely wound up either by any surviving partner or by the representatives of the deceased partner."

— *Case examples* —

A partner in a real estate firm, without disclosure to the other partner, shared land speculation profits with a client of the firm. The High Court ordered the partner's executor to account to the firm for his share of the profits. "He pursued his separate interests, where the joint interests should have been consulted, and excluded the partnership from a benefit or chance of benefit which arose out of the connection with the firm."

— *Birtchnell v Equity Trustees, Executors and Agency Co Ltd*⁴¹ —

Two partners operating a Caltex service station in Sri Lanka had agreed to terminate their partnership. Before the date of termination, partner X obtained new agreements with Caltex, with himself as sole trader. When (former) partner Y discovered the new agreement and the continued

39. *Helmores v Smith (No 1)* (1886) 35 Ch D 436 at p 444. 41. (1929) 42 CLR 384, per Dixon J at p 417.

40. Vic sec 33; NSW sec 29; Qld sec 32; SA sec 29; Tas sec 34; WA sec 40; ACT sec 34.

carrying on of business before the date of termination, he claimed his share of the profits and was successful. It was held that because partner X had continued to carry on the business with Y's capital (none of which had been repaid to Y), partner Y was accordingly entitled under the Act⁴² to such share of the profits made since dissolution as were attributable to the use of partner Y's share of the partnership assets. It was also held that the section applied which provides for the accountability of a partner who derives any benefit from his use of any partnership property without the consent of the other partners.

— *Pathirana v Pathirana*⁴³ —

In the words of the Privy Council in *Cameron v Murdoch*:⁴⁴

“It is not altogether easy to apply [WA] s 40(1), which deals with benefits derived during the continuation of a partnership, to the situation dealt with in [WA] s 40(2), namely, that which exists after a partnership has been dissolved by the death of one of the members of it, and there is a delay, for whatever reason, before the affairs of the partnership are wound up and the accounts finally settled. The duty to account under both s 40(1) and (2) relates, and relates only, to any benefit derived from any transaction concerning the partnership, or from any use of the partnership property, name or business connection. Where, after a partnership has been dissolved by the death of one partner, and the surviving partners, instead of winding up the partnership, carry on its business and make profits by doing so, and they then apply such profits, or part of them, in acquiring new or additional capital assets, the benefit which they thereby derive is not, in their Lordships' view, a benefit derived from any transaction concerning the partnership, or from any use of the partnership property, name or business connection, within the meaning of those expressions as used in s 40(1) and applied *mutatis mutandis* by s 40(2). So to hold would involve an overlap and inconsistency between s 40(2) on the one hand and [WA] s 55 on the other, and a construction of the Act which does not involve any such overlap or inconsistency between two sections of it should, in their Lordships' view, be preferred to one which does so.”

¶10-470 Duty of partner not to compete with firm. A further aspect of the fiduciary relationship is clarified by the next section:⁴⁵

“If a partner without the consent of the other partners carries on any business of the same nature as and competing with that of the firm he must account for and pay over to the firm all profits made by him in that business.”

As the gist of this section is competition with the firm, it must mean competition in the same business. Outside the defined area, a partner under

42. Vic sec 46; NSW sec 42; Qld sec 45; SA sec 42; Tas sec 47; WA sec 55; ACT sec 48; see ¶10-610.

43. [1967] AC 233. See also ¶10-610.

44. (1986) 60 ALJR 280 at p 288, noted at ¶10-610.

45. Vic sec 34; NSW sec 30; Qld sec 33; SA sec 30; Tas sec 35; WA sec 41; ACT sec 35.

a fiduciary duty retains economic liberty.⁴⁶ The section does not necessarily prevent a partner from carrying on another business which has no effect on the partnership itself, although a common provision in standard form partnership agreements is a stipulation of full time service of partners in the partnership business.

The section really catches the blatant examples, like the case where A, B, C and D are proprietors of a morning newspaper and A, B and C are proprietors of an evening newspaper. D can restrain A, B and C from first publishing a story in the evening paper obtained by the agency of the morning paper and at the expense of the firm consisting of A, B, C and D.⁴⁷

The remedies available to the aggrieved partners in these instances are numerous. They can sue for damages for breach of covenant or for misleading or deceptive conduct under the *Trade Practices Act 1974* (Cth) (§7-250ff) if applicable (§7-220) or the *Fair Trading Act* equivalents, or apply for an injunction to restrain further breaches, or they can take action for the dissolution of the firm, so long as damage resulting from the carrying on of the other business can be proved.

Similarly, at common law, a former partner in a firm of solicitors who had acted for the plaintiff, and who has confidential information (§3-685), must not act for the defendant against the former firm.⁴⁸

¶10-480 Rights of an assignee of a share in the partnership. The *Partnership Act* confirms that although partners can assign their share in the firm absolutely, by mortgage or by charge, the recipient does not as a result of the transfer become a partner in the firm. Foisting an outsider on to the partners as an unwanted partner would breach the fiduciary relationship of partnership with its mutual trust and confidence. However, the partners can consent at any time to a new partner entering the partnership. This consent may also be given in the partnership agreement. During the continuance of the business, however, the assignee simply has a right to the assignor's share of the partnership profits and to the assignor's share of the partnership assets on dissolution.

The section headed "Rights of assignee of share in partnership"⁴⁹ states: "(1) An assignment by any partner of his share in the partnership either absolute or by way of mortgage or redeemable charge does not as against the other partners entitle the assignee during the continuance of the partnership to interfere in the management or administration of the partnership business or affairs or to require any accounts of the partnership transactions or to inspect the partnership books but entitles

46. *Noranda Australia Ltd v Lachlan Resources NL* (1988) 14 NSWLR 1.

47. *Glassington v Thwaites* (1822-23) 1 Sim & St 124; 57 ER 50.

48. *Re a Firm of Solicitors* [1995] TLR 263, noted (1995) 69 ALJ 877 (solicitor free

to act, because any information the solicitor had was not, or was not now, confidential).

49. Vic sec 35; NSW sec 31; Qld sec 34; SA sec 31; Tas sec 36; WA sec 42; ACT sec 36.

the assignee only to receive the share of profits to which the assigning partner would otherwise be entitled and the assignee must [in Qld: except in case of fraud] accept the account of profits agreed to by the partners.

(2) In the case of a dissolution of the partnership whether as respects all the partners or as respects the assigning partner the assignee is entitled to receive the share of the partnership assets to which the assigning partner is entitled as between himself and the other partners and for the purpose of ascertaining that share to an account as from the date of the dissolution.”

The effect of such an assignment does not vest any interest in the assets of the partnership against the other partners, although it does confer an entitlement on the holder of the assigned interest on dissolution of the partnership in relation to the partner’s share in the partnership assets.

— Case examples —

Income-splitting by partners. The assignment by a high-income partner to his low-income spouse of six-thirteenths of his 13% share in the capital and income of the partnership was an effective assignment of an equitable chose in action (¶13-340). The subject of the assignment was the partner’s property in the partnership business, not the personal exertion of the partners. The assignment was effective for income-splitting.

FC of T v Everett⁵⁰ —

The Privy Council, on appeal from New Zealand, did not follow *Everett’s case* in a case where the assignor partner had no property interest in any income-producing capital asset of the partnership, but merely the right to share in the annual profits in proportion to his share in the partnership. This assignment was not effective for income-splitting.

Hadlee v Commr of IR⁵¹ —

DISSOLUTION OF PARTNERSHIP AND ITS CONSEQUENCES

Dissolution of partnership ¶10-490

Dissolution without a court order by retirement ¶10-500

Dissolution without a court order by expiration
or notice ¶10-510

Dissolution without a court order by death,
bankruptcy or illegality ¶10-520

Dissolution with a court order ¶10-530

Dissolution by court order: the just and equitable
ground ¶10-540

Consequences of dissolution ¶10-550

Notification ¶10-560

Authority of partners for winding up
after dissolution ¶10-570

50. (1980) 143 CLR 440; 80 ATC 4076 (High Court). 51. [1993] 2 NZLR 385; [1993] AC 524.

Partner's lien for proper administration	¶10-580
Apportionment of premiums	¶10-590
Rescission of partnership agreement or damages for fraud or misrepresentation	¶10-600
Profits made after dissolution but before winding up	¶10-610
Retiring or deceased partner's share	¶10-620
Rules for distribution of assets on final settlement of accounts	¶10-630

¶10-490 Dissolution of partnership. The final Division of the *Partnership Act* is called “Dissolution of partnership”, which deals with the end of the partnership relationship and the rights and obligations of the partners after dissolution but before winding up is completed (eg ¶10-570; ¶10-610).

Dissolution is the ending or the breaking up of the partnership (¶10-500—¶10-540).

Winding up takes place after dissolution. Winding up is the process where the partners, or an external administrator such as a receiver appointed by agreement or by the court, takes control of the partnership to liquidate assets, settle accounts, make up deficiencies or distribute the surplus in accordance with the Act unless it has been altered by agreement between the partners (¶10-630). Compare this to the winding up of a company, which is introduced at ¶9-600.

As with relations of partners to one another (¶10-370), the fiduciary relationship existing between partners continues during the process of dissolution (¶10-570).

A partnership may be dissolved as follows:

Without a court order

- By retirement of a partner where the firm is of no fixed duration (¶10-500).
- By the giving of notice (¶10-510).
- By completion of the agreed period or venture (¶10-510).
- By death or bankruptcy (¶10-520).
- By illegality (¶10-520).

With a court order

- Where a partner is suffering from a mental disorder or becomes permanently incapable (¶10-530).
- Where a partner is guilty of conduct prejudicial to the firm (¶10-530).
- Where a partner breaches the partnership agreement (¶10-530).
- Where the business can only be carried on at a loss (¶10-530).

- Where circumstances are such that it is just and equitable for the firm to be dissolved (§10-540).

¶10-500 Dissolution without a court order by retirement.

Any partner can end the partnership by giving notice of the intention to do so to all the other partners if the partnership is a “partnership at will” — ie for no fixed term. According to the section headed “Retirement from partnership at will”:⁵²

“(1) Where no fixed term has been agreed upon for the duration of the partnership any partner may determine the partnership at any time on giving notice of his intention so to do to all the other partners.

(2) Where the partnership has originally been constituted by deed a notice in writing signed by the partner giving it shall be sufficient for this purpose.”

The key to the section is the expression “no fixed term”. In the leading case on these words, *Moss v Elphick*,⁵³ it was held that every contract of partnership is a partnership at will unless some agreement to the contrary can be proved. As the agreement in this case provided for termination by mutual arrangement, it could not be said to be a partnership at will, determinable at the will of either partner. Accordingly, the section was held to be qualified by the more specifically drafted section, “Dissolution by expiration or notice”, discussed in ¶10-510. The fortnight’s notice given by partner X to partner Y to determine the partnership was held to be inoperative without the consent of partner Y.

Because a partnership is not a legal entity but is a “relation” between persons carrying on business for profit (§10-050), any change in the membership destroys the existing partnership. A provision in a partnership agreement to the effect that the firm is not dissolved by transfer of a partnership share is therefore not effective to exclude this basic principle. Instead, a change in membership may indicate the partners’ intention to create a new partnership.⁵⁴

The question has been raised whether a “retirement” of a partner is enough in itself to cause a dissolution of the firm, thereby entitling the partner to a sale of the firm’s assets and a proper financial settlement.

— Case example —

A solicitor “retired” from his firm following criminal convictions, but his former partner continued to carry on the business of the firm under the firm name, and accordingly it could not be shown that the partners had agreed on a dissolution. Therefore the solicitor was not entitled to have the firm’s assets sold since his exit was considered a retirement and a sale

52. Vic sec 30; NSW sec 26; Qld sec 29; SA sec 26; Tas sec 31; WA sec 37; ACT sec 31.

53. [1910] 1 KB 846; similarly *Walters v Bingham* (1988) 138 LJ (NS) 7; noted (1988) 9 Company Lawyer 223 (fixed

term partnership cannot be dissolved by one partner’s serving unilateral notice; fraudulently served notice of dissolution invalid if designed to conceal fraud).

54. *SJ Mackie Pty Ltd v Dalziel Medical Practice Pty Ltd* [1989] 2 Qd R 87.

was inconsistent with retirement. Instead he was entitled to what was called a proper settlement following upon his retirement.

*Sobell v Boston*⁵⁵ —

¶10-510 Dissolution without a court order by expiration or notice. The section headed “Dissolution by expiration or notice”⁵⁶ sets out three methods of dissolution of a partnership without the aid of the court:

“Subject to any agreement between the partners a partnership is dissolved—

- (a) if entered into for a fixed term by the expiration of that term;
- (b) if entered into for a single adventure or undertaking by the termination of that adventure or undertaking;
- (c) if entered into for an undefined time by any partner giving notice to the other or others of his intention to dissolve the partnership.

In the last-mentioned case the partnership is dissolved as from the date mentioned in the notice as the date of dissolution or if no date is so mentioned as from the date of the communication of the notice.”

The expression “fixed term” in para (a) is also used in the earlier section headed “Continuance of partnership on old terms”.⁵⁷ As noted above, the expression, in contrast with a partnership at will, refers to a partnership terminating on a fixed and certain date. If a fixed term partnership continues after the fixed term expires, everything will remain the same:

“(1) Where a partnership entered into for a fixed term is continued after the term has expired and without any express new agreement the rights and duties of the partners remain the same as they were at the expiration of the term so far as is consistent with the incidents of a partnership at will.

(2) A continuance of the business by the partners or such of them as habitually acted therein during the term without any settlement or liquidation of the partnership affairs is presumed to be a continuance of the partnership.”

A partnership may be governed over the years by a series of formal partnership deeds, renewed from time to time. In the interval between deeds, or at the expiry thereof, this section provides for the carrying forward of the provisions of the fixed term partnership, all things being equal.

Dissolution by completion of venture. Paragraph (b) covers similar ground when it provides that if the partnership was entered into for a fixed venture, the ending of the venture dissolves the arrangement. Two property developers who pool their resources to buy, subdivide and sell a large block will part company at the end of the venture if it is of the one-off type. On the other

55. [1975] 2 All ER 282.

56. Vic sec 36; NSW sec 32; Qld sec 35; SA sec 32; Tas sec 37; WA sec 43; ACT sec 37. See the draft winding up clause in *Letters*, LSJ, Vol 29, No 7, p 8 (August 1991). See also Dummer, C, *Partnership*

buy-outs, LSJ, Vol 30, No 1, p 82 (February 1992).

57. Vic sec 31; NSW sec 27; Qld sec 30; SA sec 27; Tas sec 32; WA sec 38; ACT sec 32.

hand, their relationship need not come to an end if they wish to continue with various subdivisions, etc.

Dissolution by the giving of notice. Paragraph (c) overlaps para (b), considered above, when it says that where no fixed term has been agreed upon, any partner can withdraw from the partnership by giving notice of intention to do so.

— *Case example* —

Partners must consent to their own resignation. The court held that the statement “I have had a gutful of this. I resign” by an “employed” partner, which was immediately accepted by all the other partners, did not constitute a resignation because all the partners (in this case, the resigning partner) were not given a proper opportunity to be consulted before the decision was made. A majority decision after consultation would have been sufficient as required by New South Wales sec 24(8) and equivalents (§10-430) if in fact there had been proper consultation.

— *Hartin v Hunter*⁵⁸ —

¶10-520 Dissolution without a court order by death, bankruptcy or illegality. The Act further provides that a partnership may be dissolved at the option of the other partners for reasons which make continuation of the partnership impossible, such as the death or bankruptcy (in Queensland, “insolvency”) of a partner or the illegality of the business of the partnership. However, bankruptcy of one partner does not necessarily terminate a partnership, and the partnership may continue without the bankrupt partner.⁵⁹ Something less than bankruptcy, such as a scheme of arrangement with creditors by a debtor who is a partner, does not dissolve the partnership of which the debtor is a member.⁶⁰

“Dissolution by death or bankruptcy or charge⁶¹

(1) Subject to any agreement between the partners every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner.

(2) A partnership may at the option of the other partners be dissolved if any partner suffers his share of the partnership property to be charged under this Act for his separate debt.”

Subsection (2) makes clear that if any partner allows their share of the partnership property to be charged under the Act for their private debts (§10-420), the other partners can dissolve the firm.

58. (1996) 39 AILR ¶5-074.

59. *Mannigel v Aitken* (1985) 72 ALR 16.

60. On the application of the joint and several estates of partners in bankruptcy proceedings, see *Bankruptcy Act 1966* (Cth) sec 110.

61. Vic sec 37; NSW sec 33; Qld sec 36; SA sec 33; Tas sec 38; WA sec 44; ACT sec 38. Ferrers, T, *How to avoid having to deal with your best friend's widow's second husband's lawyer*, Chartered Accountant, Vol 60, No 3, p 29 (April 1989).

“Dissolution by illegality of partnership⁶²

A partnership is in every case dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership.”

¶10-530 Dissolution with a court order. The Act provides six instances where a *partner* (not a creditor) can apply to the court for an order to wind up the partnership. In some cases they overlap, but their purport is the same, namely to provide partners with access to a “higher authority” in times of uncertainty. The section headed “Dissolution by the court”⁶³ provides:

“On application by a partner the court may decree a dissolution of the partnership in any of the following cases:

- (a) When a partner is found to be mentally ill, in which case the application may be made as well on behalf of that partner by his or her guardian or administrator ... or other person having title to intervene as by any other partner.
- (b) When a partner other than the partner suing becomes in any other way permanently incapable of performing his part of the partnership contract.
- (c) When a partner other than the partner suing has been guilty of such conduct as in the opinion of the court regard being had to the nature of the business is calculated to prejudicially affect the carrying on of the business.
- (d) When a partner other than the partner suing wilfully or persistently commits a breach of the partnership agreement or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable for the other partner or partners to carry on the business in partnership with him.
- (e) When the business of the partnership can only be carried on at a loss.
- (f) Whenever in any case circumstances have arisen which in the opinion of the court render it just and equitable that the partnership be dissolved.”

Ground (a): partner of unsound mind. Evidence of unsound mind provides the first instance for dissolution of partnership by the court, and this principle derives from the lack of contractual capacity held by a person considered insane under ordinary contract principles. See further ¶15-540.

Ground (b): permanent incapacity of partner. As mentioned, lack of contractual capacity deprives a person of the ability to enter contracts (including partnership contracts). Evidence of permanent incapacity on the part of one partner — such as a stroke leaving a partner unable to perform a fair share of the partnership work — may be evidence for dissolution.⁶⁴

Ground (c): conduct prejudicial. The operation of para (c) requires conduct which prejudicially affects the business. This gives wide scope to the type of

62. Vic sec 38; NSW sec 34; Qld sec 37; SA sec 34; Tas sec 39; WA sec 45; ACT sec 39.

63. Vic sec 39; NSW sec 35; Qld sec 38; SA sec 35; Tas sec 40; WA sec 46; ACT sec 40.

64. *Peyton v Mindham* [1972] 1 WLR 8.

conduct caught by the section. It need not be connected with the partnership business and such matters as criminal convictions or adverse publicity on one's private life could be sufficient. Nor need it be proved that the partnership actually suffered any loss as a result of the prejudicial conduct.⁶⁵

Ground (d): breach of the partnership agreement. Paragraph (d) concerns a failure of the fiduciary relationship which is the binding force in any partnership arrangement. It is not a trifling or an occasional breach which is caught by the section, but rather conduct of a partner, whether intentional or unintentional, which makes the continuation of carrying on business in common impracticable.⁶⁶

Ground (e): business can only be carried on at a loss. Paragraph (e) follows from the definition of a partnership as a business carried on with a view to profit. If the aim of the partnership — profit — cannot be fulfilled, and if the partners cannot agree to separate amicably, they have recourse to the court under this section to end the arrangement.⁶⁷

¶10-540 Dissolution by court order: the just and equitable ground. The final paragraph, namely (f), is the widest because it allows the court to decide just what justice and equity would require in the circumstances of a partnership wrangle. There is a vast body of company law explaining the operation of the equivalent section in the Corporations Law,¹ and its relevance in partnership law was confirmed in one of the company law cases where the judge noted that the concepts of probity, good faith and mutual confidence inherent in the section were developed by the law of partnership itself.²

— *Case examples* —

A, B and C carried on business as partners. When Mrs C set up a similar business, A and B served a notice of dissolution on C on the basis primarily of C's alleged conflict of interests, namely the conflict between his business partnership with A and B and his marriage partnership with Mrs C. A and B claimed a breach of para (c), (d) and (f), but their action failed.

First, no conflict was found which prejudiced the business of A, B and C under para (c). Secondly, there was no evidence of any troubles under para (d): indeed, there was evidence that the A, B and C partnership was thriving. Having failed on these grounds, para (f) would have been the only remaining possibility. It was agreed that C's conduct may have shaken

65. eg *Jenkins and Joaquim v Bennett* [1965] WAR 42 (¶10-540); *Bricar Nominees Pty Ltd v Rowella Pty Ltd* [1986] 1 Qd R 362 (the day before application for dissolution, partner purported to enter joint venture conveying assets of mining partnership (seven mining leases) to joint venture: an arguable case for dissolution).

66. eg *Campbell v Blair* (1873) 4 AJR 148.

67. eg *Jennings v Baddeley* (1856) 3 K & J 78; 69 ER 1029.

1. ie Corporations Law sec 461(1)(k); noted at ¶9-610.

2. *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360; [1972] 2 All ER 492; applied in *Re Kornblums Furnishings Ltd* (1981) 6 ACLR 456.

A and B's faith in him; indeed, C was held to have done a "foolish thing" which would justify A and B in subjecting his actions and the progress of Mrs C's business to close scrutiny (he did not arrange for the vendor to offer the business to A, B and C; he had exposed himself to continued temptation; having Mrs C purchase the business certainly put him in a position open to criticism), but there was no evidence of breach of trust.

— *Jenkins and Joaquim v Bennett*³ —

Radiologists. After the partnership between P and D had broken down, P wrongfully excluded D from the partnership. Because of P's lack of "clean hands" (¶1-010), the equity court refused to make an order in P's favour to wind up the partnership on the just and equitable ground. P could choose to withdraw from the partnership by invoking the buy out clause.

— *Runt v Head*⁴ —

¶10-550 Consequences of dissolution. The Act gives partners certain rights and authority which can be exercised in the winding up of the firm. It also imposes certain liabilities on persons who are still apparent members of the firm, even if they have previously retired.

A person who is not strictly speaking a partner can still be liable as a partner to outsiders, under the partnership by estoppel section (¶10-340). The circumstances in which an outsider can sue such a person are set out by the *Partnership Act* as follows:⁵

"Rights of persons dealing with firm against apparent members of firm

(1) Where a person deals with a firm after a change in its constitution he is entitled to treat all apparent members of the old firm as still being members of the firm until he has notice of the change.

(2) An advertisement in the *Government Gazette*⁶ ... shall be notice as to persons who had not dealings with the firm before the date of the dissolution or change so advertised."

In other words, old clients of the firm must be given notice express or implied (¶10-360), but a published notice will suffice for new clients.

"(3) The estate of a partner who dies or who becomes bankrupt or of a partner who not having been known to the person dealing with the firm to be a partner retires from the firm is not liable for partnership debts contracted after the date of the death bankruptcy or retirement respectively."

Under subsec (1), if it is "apparent" to a creditor that X is a partner of the firm, then provided it can be established that X is in fact a partner, the creditor can treat X as a partner of the firm until notice to the contrary. But X's liability is limited by subsec (3) which states that a partner who retires

3. [1965] WAR 42.

4. (1996) 20 ACSR 160.

5. Vic sec 40; NSW sec 36; Qld sec 39; SA sec 36; Tas sec 41; WA sec 47; ACT sec 41.

6. And, in NSW, Vic, WA and the ACT, a local newspaper.

from the firm and who was not known to the creditor before the retirement to have been a partner is not liable to the creditor for post-retirement debts. The creditor must have known that the partner who has retired was a member of the old firm, and the liability continues because of absence of notice (§10-360; §10-560) and apparent continuing membership. These principles are illustrated by two partnership cases spanning a century.

— *Case examples* —

A partnership was in debt to Elders (the supplier) for horticultural products. The supplier sued the firm to recover the amount owing, and then learned of the existence of a former partner who had retired before the period the debt was incurred. Although no notice of the retirement was given to the supplier, and no notice of retirement was advertised in the *Gazette* (§10-360; §10-560), the New Zealand High Court held that the former partner was not liable to the supplier. She could only be liable if it were “apparent” (meaning visible or evident) that she was a member of the firm. She was also not liable under the holding out section (§10-340) as she did not knowingly represent herself or allow herself to be represented as a partner.

— *Elders Pastoral Limited v Rutherford*⁷ —

The law of the letterhead. In 1986 Client invested funds in mortgages administered by law firm D and Co. When the mortgages expired in 1989, Client deposited the funds in a finance company associated with the firm. The finance company collapsed, and Client⁸ sued all persons alleged to be partners at the time of the deposit in 1989, including D. D had been a partner but had retired in 1987, and the firm’s letterhead was changed to show that D was a “consultant”. D’s name was removed in 1988, but D’s name remained on the business names registry as a partner of the firm until 1989 (§12-010), and D remained attorney of one of the firm’s entities until at least 1988 (§11-030). The court distinguished the *Elders case* (which stated that the former partner must still be an apparent partner) and held D liable to Client because of the failure to notify Client of the retirement: “a person who was an apparent member of the old firm, ie the firm as it existed before the change in its constitution, may for that reason alone continue to be treated as a member of the firm until the plaintiff has notice of the change. ‘Apparent’ is used only in relation to membership of the old firm and ‘still’ relates to continuing membership not the appearance thereof.” The court confirmed the words in subsec (1) that the firm or a retiring partner must make retirement clear to a client. In particular, an altered letterhead is not sufficient notice unless attention is drawn to the change, and it is not “notice” for the purposes of subsec (1).

— *Hamerhaven Pty Ltd v Ogge*⁹ —

A restraint of trade clause in a partnership agreement designed to prevent a former partner from competing with the firm may be void: §5-860.

7. (1990) 3 NZBLC ¶99-201, noted at [1991] NZLJ 73.

8. Client was the trustee of the client’s family trust (§9-750ff).

9. [1996] 2 VR 488, noted Fletcher, K, *Continuing liability of a retired partner* (1996) 70 ALJ 294; Webb, PRH, *Partnership letterheads — again* [1996] NZLJ 124.

¶10-560 Notification. When the partnership is dissolved, the Act gives each partner the right to make a public notification. This is an important provision, because it ensures that a retiring partner can compel the continuing or surviving partners to give any consent necessary for the publication of the required notice of dissolution under the previous section. If the continuing or surviving partners could withhold consent, they could imprison the retiring partner into liability under the section quoted in ¶10-550. This section immediately following — “Right of partners to notify dissolution”¹⁰ — overcomes this possibility:

“On the dissolution of a partnership or retirement of a partner any partner may but one of such partners shall publicly notify the same in the *Government Gazette* and in at least one newspaper circulating in each district in which the firm carries on business and may require the other partner or partners to concur for that purpose in all necessary or proper acts (if any) which cannot be done without his or their concurrence.”

¶10-570 Authority of partners for winding up after dissolution. There will be a number of matters to tie up after the winding up of a partnership, and the Act makes provision for this; in the section “Continuing authority of partners for purposes of winding up”:¹¹

“After the dissolution of a partnership the authority of each partner to bind the firm and the other rights and obligations of the partners continue notwithstanding the dissolution so far as may be necessary to wind up the affairs of the partnership and to complete transactions begun but unfinished at the time of the dissolution but not otherwise:

Provided that the firm is in no case bound by the acts of a partner who has become bankrupt [in Qld “insolvent”] but this proviso does not affect the liability of any person who has after the bankruptcy represented himself or knowingly suffered himself to be represented as a partner of the bankrupt.”

This section provides that the rights and obligations of the partners continue, despite the dissolution, as far as may be necessary to wind up the affairs of the partnership and to complete transactions begun but not completed at the time of the dissolution. This means that the section would authorise such matters as selling partnership property to pay off debts, drawing on the partnership bank account and the like, when they are done in the context of winding up.

Such transactions must observe the fiduciary relationship (¶10-370) existing between partners. For example, the purported exercise of a tenant partnership’s option to renew its lease of the firm’s premises by partner A in his own name to the exclusion of partner B was held to breach the fiduciary relationship existing between partners with respect to partnership property. In this case the lease was judged to be held by partner A as constructive

10. Vic sec 41; NSW sec 37; Qld sec 40; SA sec 37; Tas sec 42; WA sec 48; ACT sec 42.

11. Vic sec 42; NSW sec 38; Qld sec 41; SA sec 38; Tas sec 43; WA sec 49; ACT sec 44.

trustee for the partnership. The fiduciary relationship is accepted to continue after dissolution of partnership for the purpose of realisation, application and distribution of the assets of the partnership.

— *Case example* —

The partnership agreement between Dr Z and Dr C provided (amongst other things) that upon termination of their medical practice, an account was to be taken of assets and liabilities of the firm, assets were to be sold, liabilities discharged, expenses paid and the balance divided equally between the two partners. One asset of the firm was its lease, which would be able to be transferred at a premium but it was due to expire shortly after Dr C's notice of termination unless its option of renewal was exercised (§13-250; §15-365). Instead of joining Dr Z in exercising the option on behalf of the firm, Dr C purported to exercise the option on his own account, to the exclusion of Dr Z, in order to continue medical practice in the premises of the former firm. The High Court confirmed that the fiduciary relationship between partners (§10-370; §10-450—§10-470) continues after the dissolution of the firm, and because the lease and its option for renewal were partnership assets, Dr C's renewal was as constructive trustee for the firm (§19-755): it would have been inequitable for Dr C to retain the new lease which could not have been granted if the firm's option had been exercised.

— *Chan v Zacharia*¹² —

A fiduciary relationship equally exists between intending partnerships once they enter into partnership negotiations and arrangements with a view to forming a partnership. An intending partner taking up, as sole lessee, a lease intended for the firm, to the exclusion of the other intending partner, holds the lease in trust for himself and the other intending partner.¹³

¶10-580 Partner's lien for proper administration. When the firm is dissolved, every partner is entitled to have the property of the partnership sold and the net proceeds applied in payment of the amount due to the partner in respect of the partner's share (subject to set-off for what the partner may owe the firm). In particular, on dissolution a partner is entitled to have the goodwill of the business sold for the common benefit of all the partners.¹⁴ The section headed "Rights of partners as to application of partnership property"¹⁵ provides:

"On the dissolution of a partnership every partner is entitled as against the other partners in the firm and all persons claiming through them in respect of their interests as partners to have the property of the partnership applied in payment of the debts

12. (1984) 154 CLR 178; (1984) 58 ALJR 353, noted by Starke, JG, *The durability of the Rule in Keech v Sandford* (1984) 58 ALJ 660; followed, eg, *Gibb Australia Pty Ltd v Cremor Pty Ltd* (1992) 108 FLR 129 (Full Court, ACT).

13. *Fraser Edmiston Pty Ltd v AGT (Qld) Pty Ltd* [1988] 2 Qd R 1.

14. A case law principle, set out only in the WA Act in sec 51.

15. Vic sec 43; NSW sec 39; Qld sec 42; SA sec 39; Tas sec 44; WA sec 50; ACT sec 45.

and liabilities of the firm and to have the surplus assets after such payment applied in payment of what may be due to the partners respectively after deducting what may be due from them as partners to the firm, and for that purpose any partner or his representatives may on the termination of the partnership apply to the court to wind up the business and affairs of the firm.”

A lien is created by this section, ie a personal right against the co-partners and their representatives. It guarantees proper administration and ensures that debts of the firm are paid before any debts of individual partners. This non-possessory lien, created by statute, is noted further at ¶13-280.

¶10-590 Apportionment of premiums. It sometimes happens that a partner joining a firm will be required to pay a premium for the privilege (as opposed to a contribution of capital, which will of course remain property of the partner). On dissolution, the question will inevitably arise — how will the partners deal with the premium? The Act sets out the principles as follows, in the section headed “Apportionment of premium where partnership prematurely dissolved”:¹⁶

“Where one partner has paid a premium to another on entering into a partnership for a fixed term and the partnership is dissolved before the expiration of that term otherwise than by the death of a partner the court may order the repayment of the premium or of such part thereof as it thinks just having regard to the terms of the partnership contract and to the length of time during which the partnership has continued; unless—

- (a) the dissolution is in the judgment of the court wholly or chiefly due to the misconduct of the partner who paid the premium; or
- (b) the partnership has been dissolved by an agreement containing no provision for a return of any part of the premium.”

For example, in the leading case *Atwood v Maudé*,¹⁷ on which the section was modelled, an inexperienced solicitor paid a premium of £800 to be taken into a seven-year partnership with a senior solicitor. After only two of these years had run, the junior solicitor sought a dissolution on the grounds of the senior partner’s incompetence. Rejecting the senior partner’s claim that it was the junior partner’s incompetence which led to the breakdown, the court stated that it would be inequitable for the senior partner to retain the premium — to profit from his own wrongdoing — and ordered a full return of the premium.

¶10-600 Rescission of partnership agreement or damages for fraud or misrepresentation. As with other contracts, the partnership contract can be rescinded for any fraud or misrepresentation which occurred in the negotiations leading to the contract (eg ¶5-700). The

16. Vic sec 44; NSW sec 40; Qld sec 43; SA sec 40; Tas sec 45; WA sec 53; ACT sec 46.

17. (1868) 3 Ch App 369.

party entitled to rescind has, without prejudice to any other right, certain statutory rights:¹⁸

“Rights where partnership dissolved for fraud or misrepresentation

Where a partnership contract is rescinded on the ground of the fraud or misrepresentation of one of the parties thereto the party entitled to rescind is without prejudice to any other right entitled—

- (a) to a lien on or right of retention of the surplus of the partnership assets after satisfying the partnership liabilities for any sum of money paid by him for the purchase of a share in the partnership and for any capital contributed by him;
- (b) to stand in the place of the creditors of the firm for any payments made by him in respect of the partnership liabilities; and
- (c) to be indemnified by the person guilty of the fraud or making the representation against all the debts and liabilities of the firm.”

So, in one case¹⁹ it was held that a partner had a lien in respect of interest on capital contributions and money paid by him for the purchase of his share from the time they were paid, as well as his costs of the rescission proceedings.

In addition to these special rights conferred by para (a)-(c), an aggrieved partner will have a further right, namely a claim to damages either for fraud or for misrepresentation.

— *Case example* —

C bought five shares for \$20,000 (Singapore) in S's stock and sharebroking firm (described by S as a “gold mine”) under an agreement which made C a partner. When S went away on holiday, C took over as managing partner and then had her first opportunity to see the partnership books. Discovering uncollectable debts to the extent of hundreds of thousands of dollars and a \$250,000 (Singapore) overdraft, she claimed a return of her \$20,000. She sued for the amount, claiming not fraudulent but innocent misrepresentation. A rescission order was made, the amount refunded and the partnership dissolved.

— *Senanayake v Cheng*²⁰ —

¶10-610 Profits made after dissolution but before winding up. After dissolution of a partnership or after the retirement of one of the partners, the surviving or continuing partner(s) may still carry on the business of the firm using its capital or assets without any final settlement of accounts. The Act provides that continuing partners who use the share of a deceased or former partner without any final settlement of accounts will be liable to account for—

- (1) the share so used,
- (2) any profits derived from the share, and/or

18. Vic sec 45; NSW sec 41; Qld sec 44; SA sec 41; Tas sec 46; WA sec 54; ACT sec 47.

19. *Mycock v Beatson* (1879) 13 Ch D 384.

20. [1966] AC 63; [1965] 3 All ER 296.

(3) interest on the share.

The section headed "Share profits made after dissolution"²¹ reads:

"Where any member of a firm has died or otherwise ceased to be a partner and the surviving or continuing partners carry on the business of the firm with its capital or assets without any final settlement of accounts as between the firm and the outgoing partner or his estate then in the absence of any agreement to the contrary the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since the dissolution as the court may find to be attributable to the use of his share of the partnership assets or to interest at the rate of seven per centum per annum on the amount of his share of the partnership assets;^[22]

Provided that where by the partnership contract an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner and that option is duly exercised the estate of the deceased partner or the outgoing partner or his estate as the case may be is not entitled to any further or other share of profits, but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof he is liable to account under the foregoing provisions of this section."

— *Case examples* —

P was the sole surviving partner of the firm of A and B, timber merchants, which had been dissolved by the death of the former partner. Because post-dissolution profits had been earned mainly by skilful management by P and not from the use of the assets of the firm, these profits were to be excluded in working out what was due to the estate of the former partner.

*Manley v Sartori*²³ —

Where partner X had continued to carry on the business (a Caltex service station in Sri Lanka) with partner Y's capital (none of which had been repaid to Y), partner Y was entitled under this section to whatever share of the profits was attributable to the use of Y's assets in the business.

*Pathirana v Pathirana*²⁴ —

A partnership farming business carried on for some 40 years after the death of the senior partner (father) by the surviving two partners (sons), with no final settlement of accounts, gave rise to numerous competing property claims by family members. Draft orders handed down by the judge in the Supreme Court of Western Australia included an order for final settlement of accounts under this section with the entitlement of the estate continuing until that time. However, rather than applying the statutory rate of return for the use of partnership assets for the years 1940-1983 (6% per annum in Western Australia on the net value of the partnership estate), the judge applied the following analysis of the winding up provisions which has been

21. Vic sec 46; NSW sec 42; Qld sec 45; SA sec 42; Tas sec 47; WA sec 55; ACT sec 48; (cf ¶10-630).

22. 6% in NSW, WA and Tas; 5% in Qld.

23. [1927] 1 Ch 157; [1926] All ER Rep 661.

24. [1967] AC 233, discussed at ¶10-460.

developed in recent years,²⁵ and held that until realisation of the partnership business and assets the surviving partners were trustees of the business of the deceased partner's estate for the estate and for themselves. Therefore any increase in the value of the assets was held by the surviving partners for the benefit of the estate and themselves. Hence, until realisation of the assets of the partnership at the date of death (43 years earlier), the deceased partner's estate was entitled to the increased value of those assets from the date of death until the date of realisation. Improvements to partnership assets made by the continuing partners in disregard of the rights of other family members were held to give no charge over the estate's interest in the partnership.

*Cameron v Murdoch*²⁶

In subsequent proceedings in this case, it was held that in determining profit (for the purpose of the account ordered to be taken of what was due to the estate of the deceased partner in respect of partnership profits 1940-1983), losses should be taken into account but not managerial allowances on the part of the surviving partners or their representatives. In the absence of accounting records, notional profit and loss was to be assessed by reference to comparative information.²⁷

— *Case examples* —

Newsagents. P contributed about £4,500 and D contributed about £23,000 to the capital of a newsagent partnership which they carried on in a rented shop. When the partnership was dissolved, D continued the business alone, and later purchased the shop freehold for £80,000. Three years later, D sold the shop and the business for £185,000. P was successful in claims that:

- (1) D held the sale profits on trust for the former firm of P and D in equal shares; and
- (2) P was entitled to share the post-dissolution capital profits (£10-390) equally under the equivalent of NSW and SA sec 24(1) and equivalents: £10-430.

*Popat v Shonchhatra*²⁸

A partner who retired from a law firm was entitled to a share of the profits of the continuing firm in the period between retirement and the final settlement of accounts:

- there had been no accounting to the retired partner for his share of the assets of the firm at the date of retirement;
- the continuing partners continued to have use of the partner's share

25. *Meagher v Meagher* [1961] IR 96; *Barclays Bank Trust Co Ltd v Bluff* [1982] 1 Ch 172: an interpretation arguably in conflict with the subsequent section (£10-620) which clearly states that the interest of a deceased partner is a debt and not a beneficial interest.

60 ALJR 280, noted Australian Accountant, Vol 56, No 7, p 72 (August 1986).

27. *Cameron v Murdoch (No 2)* [1984] WAR 278.

28. [1997] 3 All ER 800; £10-390.

26. [1983] WAR 321, noted (1984) 58 ALJ 731; upheld by the Privy Council (1986)

of the partnership assets even if that share provided only a small part of the funding for the continuing business;

- it was irrelevant that the partner's personal effort for the benefit of the continuing partnership had been negligible;
- there was no agreement that the firm be dissolved on the retirement of the partner, and the fact that the firm continued after the retirement did not affect the operation of this section.

Oddy v Fry²⁹ —

But the outgoing partner's entitlement to a share of the profits must be seen in the light of that partner's contribution. "Profit" in this section refers to profits accruing in the ordinary course of carrying on the partnership business pending realisation and does not include any increase in the value of partnership assets (such as a fortuitous rise in real estate values since the date of death) occurring after the death of the deceased partner.³⁰

¶10-620 Retiring or deceased partner's share. Under arrangements for paying out the share of a deceased or outgoing partner, the Act states that the amount is a debt which accrues at the date of the dissolution or death. The section headed "Retiring or deceased's partner's share to be a debt"³¹ provides:

"Subject to any agreement between the partners the amount due from surviving or continuing partners to an outgoing partner or the representatives of a deceased partner in respect of the outgoing or deceased partner's share is a debt accruing at the date of the dissolution or death."

This simply means that the surviving partner is a debtor in respect of the deceased or outgoing partner's interest in the partnership. Therefore, time under the relevant *Statute of Limitations* (¶6-330) will run from the time the partnership estate becomes vested in the surviving partner as a result of the death or retirement of the other partner or partners.

¶10-630 Rules for distribution of assets on final settlement of accounts. The rules on final settlement of partnership accounts are set out by the Act and apply subject to any agreement to the contrary. Essentially, the procedure is that of commonsense: first, all the partnership assets, such as debts owed to the firm, are to be got in. The concept of partnership property, as considered above at ¶10-390, may present some problems of definition. Secondly, such assets as can be sold will be sold, and every partner has a right to insist on sale following dissolution. Finally, the sale proceeds are used to pay off all debts such as debts and liabilities of the firm, repayment of advances to partners, legal costs and repayments of capital to partners.

29. [1998] 1 VR 142, noted Nichol, C and Bromby M, *Partnership profits at risk* (1999) 73(1) LIJ 44.

31. Vic sec 47; NSW sec 43; Qld sec 46; SA sec 43; Tas sec 48; WA sec 56; ACT sec 49.

30. *Cameron v Murdoch* [1983] WAR 321.

The Act sets it out logically, under the heading “Rule for distribution of assets on final settlement of accounts”;³²

“In settling accounts between the partners after a dissolution of partnership the following rules shall subject to any agreement be observed:

- (a) Losses including losses and deficiencies of capital shall be paid first out of profits next out of capital and lastly if necessary by the partners individually in the proportion in which they were entitled to share profits;
- (b) The assets of the firm including the sums (if any) contributed by the partners to make up losses or deficiencies of capital shall be applied in the following manner and order:
 - (i) In paying the debts and liabilities of the firm to persons who are not partners therein;
 - (ii) In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital;
 - (iii) In paying to each partner rateably what is due from the firm to him in respect of capital;
 - (iv) The ultimate residue (if any) shall be divided among the partners in the proportion in which profits are divisible.”

Where capital has been contributed by the partners in unequal proportions and the capital is lost and has to be made good by the partners, it must be made good by them in the same proportion as any other loss.³³

As stated in para (b)(iv), the “ultimate residue” left after payment of debts and profits (considered to be profit, not capital) is divided not in proportion to the partners’ respective capital contributions but in the proportion in which profits are divisible.

— Case example —

The deed of a Queensland limited partnership (¶10-190) formed for mining provided that 40% of the balance of the distributable profits be paid to the general partner and that 60% be paid to the special partners in proportion to their respective contributions to capital. In fact, as agreed under the law of limited partnerships, the general partner contributed no capital to the firm. The High Court interpreted the deed as entitling the general partner to 40% of the profits while the partnership was carrying on its business and, by application of para (b)(iv), to 40% of the ultimate residue.

— *Rowella Pty Ltd v Abfam Nominees Pty Ltd*³⁴ —

Where, after termination but before winding up, a partner borrowed money at interest to pay partnership debts, that partner is entitled to credit for the interest paid, on the basis that where one of several joint debtors pays a debt, the debtor is entitled to contribution from the others.³⁵

32. Vic sec 48; NSW sec 44; Qld sec 47; SA sec 44; Tas sec 49; WA sec 57; ACT sec 50.

34. (1989) 168 CLR 301; (1989) 64 ALJR 121.

33. *Re Albion Life Assurance Society* (1880) 16 Ch D 83, per Jessel MR at pp 87-88.

35. *Bartels v Behm* (1990) 19 NSWLR 257.

Where profits are to be equally shared, normally losses would also be equally shared, but in a case where one partner is insolvent a different procedure applies. *Garner v Murray*³⁶ authorises the legal proposition applied by accountants that where one partner is in debt and insolvent, the solvent partners share the debt in the ratio of the "last agreed capitals", ie the loss is borne by the solvent partners in the proportion of their fixed capitals at the date of dissolution.

36. [1904] 1 Ch 57; see Brooker, RP, *The Dissolution of Partnership — Garner v Murray* (1967) 3 Abacus 36; Brooker, RP, *The Background of Garner v Murray* (1968) 4 Abacus 73; Houghton, KA, *Law and accounting: confusion surrounding the "Rule in Garner v Murray"* (1981) 17

Abacus 41; Houghton, KA, *Partnership dissolution: treatment of the overdrawn capital of an insolvent partner* (1982) 18 Abacus 91; Ley, DG, *Capital gains: application to disposal of partnership assets and interests* (1989) 63 LJ 1021.

Chapter 11

Agency

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ESSENTIAL PRINCIPLES

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¶11-010 Legal v commercial meaning of agency. The commercial world abounds with “manufacturer’s agents”, “literary agents”,
¶11-010

“sole selling agents”, “Western Australian agents for X” and the like. Although “agency” is an everyday word with a meaning covering operations as diverse as independent organisations, distribution outlets and service centres, its importance in the business law context lies in its legal meaning and the role of the agent as go-between or intermediary.

Agency law involves a cast of three:

- principal (Pr),
- agent (A), and
- third party (TP).

The transaction brought about by an agent, ie an agent in the strict legal meaning, binds the agent’s principal and the third party contracted with, and if the agent has acted within the agency these are the only parties bound by the contract. Being only an intermediary, the agent is not party to the final arrangement.

While the law is clear on what it regards as an agent, the word itself is often used and understood in business in quite another sense. In its general commercial sense an agent is a person who is able to introduce persons who may wish to transact business, but who by the act of introducing persons in no way binds them. The difference between the two meanings was expressed as follows:¹

“In connection with sales and purchases of property the word ‘agent’ is apt to be used in a misleading way. The legal conception of agency is expressed in the maxim ‘*Qui facit per alium facit per se*’,^[2] and an ‘agent’ is a person who is able, by virtue of authority conferred upon him, to create or affect legal rights and duties as between another person, who is called his principal, and third parties. When a person is employed to find a buyer of property, he is commonly said to be employed as an agent, and the term ‘estate agent’ is a common description of a class of persons whose business is to find buyers for owners who wish to sell property. But the mere employment of such a person under the designation of agent does not, apart from the general rule that the employer will be responsible for misrepresentations made by him, necessarily create any authority to do anything which will affect the legal position of his employer.”

¶11-020 When is an agent not an agent? Many business relationships involve agency, but not all agents in the business sense are agents according to agency law with the ability to commit Pr to a contract with TP.

Selling agent. A person who has the exclusive right to resell the goods of a manufacturer or a distributor such as the “sole agent” or “exclusive agent” or “authorised agent” for a particular car is not usually an agent in the legal sense

1. *Petersen v Moloney* (1951) 84 CLR 91 at pp 94-95.

2. This Latin maxim translates as “he who acts through another is deemed to act in

person” (ie a principal is liable for the acts of his agents).

with the power to bind the principal. These agents run their own business, and “[n]o one supposes that the ‘distributing agent’ or ‘exclusive agent’ in a particular ‘territory’ for a proprietary commodity or specific kind of article or machine is there to put a ‘consumer’ into contractual relations with the manufacturer.”³

Employer/employee. An employee is under the control and supervision of the employer but this does not mean that the employee is the agent of the employer.⁴ Some employees have authority to bind employers — for example, a salesperson (A) has authority to make contracts on behalf of the store (Pr) with customers (TPs).

Independent contractor. An independent contractor is hired on a contract of *services* for a specific task (or tasks) whereas an employee is employed on a contract to provide *service*. An independent contractor may or may not be an agent, depending on the relationship between the hirer and the independent contractor. The question of control provides the test to distinguish the independent contractor from the employee:⁵

“A prominent factor in determining the nature of the relationship between a person who engages another to perform work and the person so engaged is the degree of control which the former can exercise over the latter. It has been held, however, that the importance of control lies not so much in its actual exercise, although clearly that is relevant, as in the right of the employer to exercise it ... But the existence of control, whilst significant, is not the sole criterion by which to gauge whether a relationship is one of employment. ... Other relevant matters include, but are not limited to, the mode of remuneration, the provision and maintenance of equipment, the obligation to work, the hours of work and provision for holidays, the deduction of income tax and the delegation of work by the putative employee.”

The extent of direction and control is the most important criterion in deciding whether a person is an employee or an independent contractor:

- Weight watchers lecturers were held to be employees, not independent contractors, as their work practices were imposed by the employer;⁶
- Crisis Couriers, who delivered parcels mostly by bicycle, were held to be independent contractors on the basis that each was self-employed, was paid for each successful delivery, used their own equipment and faced the possibility of a loss of capital.⁷

3. *International Harvester Co of Australia Pty Ltd v Carrigan's Hazeldine Pastoral Co* (1958) 100 CLR 644 at p 653.

4. The law used to call the employer/employee relationship that of master and servant.

5. *Stevens v Brodribb Sawmilling Company Pty Ltd* (1986) 160 CLR 16 at p 23.

6. *Narich Pty Ltd v Commr of Pay-roll Tax (NSW)* (1983) 2 NSWLR 597; 84 ATC 4035.

7. *Vabu Pty Ltd v FC of T* 96 ATC 4898, criticised by Gerber, P, *Employees and independent contractors revisited* (1999) 73 ALJ 29, preferring the “economic reality” test.

Of course, the general rules of contract (eg the parol evidence rule, see ¶15-030) apply to help the analysis.

Partners. Partnership also involves an agency relationship, whereby each partner is both principal and agent of all the partners of the firm. See ¶10-200.

Trustees. Even though representing the beneficiaries, a trustee is not normally agent of the settlor or the beneficiaries. The trustee is the legal owner of the property held in trust answerable in equity (¶9-760).

Company directors and other company personnel are agents of their companies in most situations: ¶9-470—¶9-480.

Bailee. A bailee is a person who has possession of goods of the bailor, such as a repairer or a carrier (Chapter 15). This relationship may authorise the bailee to contract on behalf of the bailor if this is agreed in the appointment of the bailee.

The franchisor/franchisee relationship does not normally involve agency, as the franchisee usually acts independently of the franchisor (¶9-991).

¶11-030 Forms of agency. Agency may take any one of the following forms.

The universal agent has unrestricted authority to act for Pr.

- **Power of attorney.** A universal agent or a general attorney may be appointed by a power of attorney.⁸ This is a deed signed by Pr and independently witnessed where Pr (the donor of the power) gives A (the donee, or the attorney under the power) the authority to act for Pr. For example, A may be travelling or living overseas for a period, or may be in hospital or have limited mobility. The power may be general, or it may be limited to a particular area (such as Tasmania), purpose (eg sale of a particular property) or period of time (eg one year). A power of attorney can give peace of mind, and spouses or family members may give each other power of attorney in case of accident or absence. Ambiguities in a power of attorney are read down in favour of Pr, the person who created the power. A power of attorney can be stopped like any other agency appointment (¶11-360—¶11-370).⁹

8. Land law legislation in each jurisdiction provides that a power of attorney must be registered on public record before an attorney can deal with land both under old system/general law and under Torrens title: eg *Conveyancing Act 1919* (NSW)

sec 163-163H; *Transfer of Land Act 1893* (WA) sec 143-145.

9. eg Collier, B and Lindsay, S, *Powers of Attorney in Australia and New Zealand*, Federation Press, 1992; Lipton, JD, *Powers of attorney* (1995) 69 LIJ 660.

- *Short form power of attorney.* Many jurisdictions provide for an easy-to-use short form power of attorney to overcome possible interpretation problems:¹⁰

“1. I APPOINT ANNE ATTORNI of,, to be my attorney.

2. I AUTHORISE my attorney to do on my behalf anything that I may lawfully authorise an attorney to do.”

- *Enduring power of attorney.* A power of attorney lapses by operation of law such as mental incapacity (§11-360). A number of jurisdictions provide for an “enduring power of attorney” or a “living will” so that people can plan ahead of time for care and financial management in their old age by appointing an attorney or manager to act on their behalf if they become incapacitated.¹¹ Some jurisdictions authorise a general or an enduring attorney to make decisions concerning medical treatment.¹²

The general agent has lesser powers and these are confined to the authority to represent the principal in all matters in a particular trade or profession or in business of a certain kind. For example, A may be employed to manage all the principal’s shops; or A may be employed as a travelling representative; or A may be employed to do an act which is within the normal scope of A’s own business such as the appointment of a real estate agent to sell a house.

The special agent has even more narrowly defined powers. A’s appointment is for a specific purpose, or to perform a particular function which is *not* within the course of A’s usual business such as requesting a real estate agent to sell not the house, but the furniture in it. If this could be demonstrated to be outside the ordinary business of a real estate agent — as presumably it is — the legal status of the person performing would be that of a special agent.

The del credere agent is an agent, employed by Pr to sell goods, who guarantees that clients introduced by A to the principal will pay for the goods sold. A guarantees that the parties to whom A sells goods on behalf of the principal will pay for them: if they do not pay, the *del credere* agent will. In return for this guarantee, the *del credere* agent is paid an extra

10. eg *Conveyancing Act 1919* (NSW) sec 163B, also applying in the ACT: see Johnstone, T and Seddon, N, *Some thoughts on powers of attorney* (1987) 111 Newsletter of the Law Society of the ACT 72; *Instruments Act 1958* (Vic); *Powers of Attorney and Agency Act 1984* (SA).

11. *Conveyancing Act 1919* (NSW) sec 160; *Instruments Act 1958* (Vic) sec 114; *Powers of Attorney Act 1998* (Qld) Ch 3; *Property Law Act 1969* (WA) sec 86,

87; *Powers of Attorney and Agency Act 1984* (SA) sec 6-11a; *Powers of Attorney Act 1934* (Tas) sec 10, 11; *Powers of Attorney Act 1956* (ACT) sec 12-18 (added 1989); *Powers of Attorney Act 1980* (NT) Pt III. This gives effect to the ALRC’s Report No 47, *Enduring Powers of Attorney*, AGPS, 1989, noted [1988] Reform 26, [1989] Reform 103.

12. eg *Medical Treatment Act 1988* (Vic) sec 5A; *Assisted and substituted decisions*, QLRC, 1995.

commission.¹³ If the buyer defaults, Pr first sues the buyer, and can then turn to the *del credere* agent for the shortfall.

Other classes of agency are introduced at ¶11-380.

¶11-040 Creation of agency. Agency can be created in the following ways:

- (1) Express agreement — actual authority given orally or in writing: ¶11-050.
- (2) Implied agreement — authority can be implied from the following actions or relationships:
 - Implied agreement from cohabitation: ¶11-080.
 - Implied agreement from partnership: ¶10-235.
- (3) Apparent authority *or* ostensible authority *or* agency by estoppel. A person who by words or conduct holds out another person as agent is estopped from denying agency: ¶11-130 (like partnership by estoppel: ¶10-340).
- (4) Agency formed by operation of law — agent of necessity: ¶11-070.
- (5) Creation of agency by ratification — where Pr adopts the contract made by A: ¶11-090.
- (6) the undisclosed principal may be able to enforce a contract made by A: ¶11-340.

¶11-050 Creation of agency: express agreement. Agency can be created by express agreement between Pr and A — the agreement does not necessarily have to be by way of contract and Pr does not necessarily have to provide consideration (or price) to appoint A.

Appointment of an agent need not be by formal documentation, and in most cases it can be verbal. An agent may be appointed by power of attorney (¶11-030), a document normally executed as a deed (under seal: ¶5-040) which is stamped (ie stamp duty paid) and registered. Only in the case of the *Statute of Frauds* requirements for written contracts (¶5-030) will appointment in writing be necessary. Some jurisdictions have a requirement by statute that some classes of authorisation of an agent be in writing signed by the principal.¹⁴

For example, a stockbroker may be appointed to buy or sell shares for a client. A solicitor may be appointed to represent a client in legal proceedings. A manager may be appointed by a professional athlete to handle all “business”.

13. eg *Toycorp Ltd (Receivers and Managers Appointed) v Milton Bradley Australia Pty Ltd* [1992] 2 VR 572 at p 575.

14. Where the agency is to last for a period of over one year, the *Statute of Frauds*

1677 (Imp) or local equivalent in most jurisdictions applies which requires evidence in writing for the agreement to be enforceable. See ¶5-030.

Some classes of agent are required to be licensed before they can act as an agent — such as a sharebroker, solicitor, travel agent (§11-390) and real estate agent (§11-410) — to show that they have the necessary qualifications and experience.

§11-060 Creation of agency: implied agreement. An agent may have authority implied from the circumstances to achieve the purpose of Pr. Authority may be implied from what is usual and from what is customary according to current usage (§11-120). Two examples are agency implied from cohabitation (§11-080) and from partnership (§10-235).

§11-065 Creation of agency by estoppel. Pr is estopped (stopped) from denying that A is its agent and is bound by the actions of A (if the actions are within A's apparent authority) if:

- Pr has by words or conduct held out A to TP to be its agent;
- TP has relied on Pr's holding out of A; and
- it is reasonable for TP to rely on the holding out of A.

— Examples —

- (1) Pr may be committed to the actions of A because of agency by estoppel after the agency has been terminated but where Pr has *not* notified existing TPs (customers) and where they continue to deal with the former agent assuming that A is still working for Pr.
 - (2) The continuing partners in a partnership may be committed to the actions of a retired partner because of agency by estoppel where the continuing partners have *not* notified existing TPs (customers) and where they continue to deal with the former partner: §10-550.
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§11-070 Creation of agency by operation of law: agent of necessity. The law also recognises situations where agency can arise contrary to the intentions or even the wishes of the parties.

An *agent of necessity* is a person who in an emergency where communication is impossible acquires by law presumed authority to act as an agent for the benefit of another person, the principal. There are four requirements for agency of necessity to arise:

- (1) an existing contractual relationship where one person (A) has been entrusted with the property of another person (Pr). It is doubtful whether a so-called Pr could be bound by the actions of a complete stranger (A) who owed no duty to Pr;
- (2) an emergency;
- (3) the impossibility of communication by A with Pr, the owner of the property, to obtain Pr's instructions; and
- (4) A must act in good faith in the interests of Pr.

§11-060

Agency law recognises certain categories of agency of necessity. A *ship's master* is entitled in the event of an accident or emergency to enter into a contract — to enable completion of the voyage or to avoid further loss — which will bind the owners of the ship or the cargo. This authority is in addition to the master's normal authority to make arrangements for the carrying out of the voyage. For example, a shipmaster, unable to contact the owner of the damaged ship, sold the ship by public auction to cut the owner's losses: "[U]pon the whole, the conduct of the Master in selling the vessel was not merely an act of prudence; not merely an act done for the advantage of his owner, but was an act of absolute necessity."¹⁵ This authority of the ship's master is said to depend on inability to communicate with the owner from a distant port. In view of modern communication, however, this authority may have to be read subject to the owner's instructions unless communication really is impossible — eg in the case of war or unsettled political conditions, leading to a real breakdown in communications.

A *land carrier* of goods has been held to possess the same authority as a ship's master in respect of perishable goods and in respect of costs incurred to feed livestock.

— *Case example* —

D sent a horse by rail but there was no one to meet it when it arrived at the station at night. The station master (as agent of railway P), who did not know D's address, sent the horse to a livery stable near the station for safe custody, and paid the stable charges. P would have been in breach of its duty as carrier if it had failed to take care of the horse (§15-135). P succeeded in its claim for the stable charges from D.

— *Great Northern Railway Co v Swaffield*¹⁶ —

The court confirmed not a power but a duty of the carrier in the event of accident and emergency to act for the safety of the cargo, and that, as a corresponding right, the carrier is entitled to charge the owner with the expenses properly incurred in so doing.

However, carriers may be liable in the torts of detainment and/or conversion (§4-020) for detaining cargo unless they come within the test of agency of necessity.

— *Case example* —

Delivery of a consignment of tomatoes for carriage to Covent Garden from the Channel Islands had been delayed by storms, and further shipment was going to be delayed by a rail strike. The railway company decided to sell the ripening tomatoes locally. Action for conversion (§4-020) by the consignee succeeded because it was held that the carrier/railway company

15. *Lapraik v Burrows, The Australia* (1859) 13 Moo PC 132 at p 160; 15 ER 50 at p 60.

16. (1874) LR 9 Ex 132; [1874-80] All ER Rep 1065.

could have communicated with the consignee to get instructions, and was therefore not authorised to sell as agent of necessity.

— *Springer v Great Western Railway Company*¹⁷ —

Bailees (see ¶15-070—¶15-150) have not been recognised as being in the same position as carriers with respect to a power of sale, especially if the goods in question are not perishable or if they are sold merely because of inconvenience to the bailee.¹⁸

¶11-080 Creation of agency by operation of law: cohabitation. A spouse or de facto spouse is presumed to have authority to pledge credit for necessities which are suitable to the parties' style of living and which fall within the domestic management of the spouse.¹⁹ This right is a presumption of fact only which is founded on the supposition that spouses cohabiting do have express or implied authority to manage certain aspects of the household finances.

The necessities over which a wife may pledge a husband's credit have been defined as things which are really necessary and suitable to the style in which the husband chooses to live in so far as the articles fall within the wife's normal authority.²⁰

— *Case example* —

The husband was a miner who earned £10 per fortnight. A trader supplied the wife with a diamond ring worth £11.15.0. Necessity could not be implied: "it is idle to suggest that to people who live under those conditions, a diamond ring is a necessary".

— *Pianta v Macrow and Sons Pty Ltd*²¹ —

It has also been held that the onus of proof lies on the supplier/tradesperson to show that the goods/services supplied to the wife are necessities.²² If they are found to be articles of luxury, the wife's authority cannot be presumed to have arisen.

It is unclear whether a wife's presumed authority to pledge her husband's credit for necessities can be rebutted. If a husband expressly warns third parties not to supply goods on credit, and if goods are supplied, authorities differ on the question of the husband's liability.²³

17. [1921] 1 KB 257; [1920] All ER Rep 361.

18. *Sachs v Miklos* [1948] 2 KB 23; [1948] 1 All ER 67.

19. *Debenham v Mellon* (1880) 6 App Cas 24 at p 36. This presumption does not apply in, eg, the NT: *Married Persons (Equality of Status) Act 1989* (NT) sec 5. Under sec 104 of the *Law of Property Act 1936* (SA), a husband is not liable because of any presumed agency for debts incurred by his wife.

20. *Phillipson v Hayter* (1870) LR 6 CP 38 at p 42.

21. (1925) 27 WALR 99 at p 101.

22. *Phillipson v Hayter* (1870) LR 6 CP 38 at p 42.

23. See further Hardingham, IJ, *A married woman's capacity to pledge her husband's credit for necessities* (1980) 54 ALJ 661.

If the husband and wife have since separated, the husband will be responsible for the wife's debts until the husband notifies persons who formerly gave credit to the wife on account of the husband.

¶11-090 Creation of agency: ratification. Ratification is Pr's adopting or confirming an act done by A for Pr, not originally binding on Pr. Ratification is equivalent to original authority,²⁴ and by ratification the relationship of principal and agent is constituted retrospectively. Unauthorised actions of A can also be ratified — or validated — by Pr to make a binding contract:

— *Case example* —

Retrospective ratification by Pr. TP offered to buy property from A, the acting manager of Pr Ltd. A, who was not authorised to make any sale contracts for Pr, accepted TP's offer. (TP was not aware of A's lack of authority.) TP then revoked its offer to buy, but later Pr purported to ratify A's unauthorised acceptance retrospectively. Pr was entitled to an order of specific performance (¶6-400), as the court held that Pr's ratification related back to A's acceptance and that a contract was formed at this time. TP's later revocation was therefore ineffective. In the words of the judge, "I can find no authority in the books to warrant the contention that an offer made, and in fact accepted by a principal through an agent or otherwise, can be withdrawn."

— *Bolton Partners v Lambert*²⁵ —

For ratification to be effective, there are certain prerequisites:

- (1) *The act must be expressly on behalf of the principal.* A must contract expressly as an agent for a principal. A's status must be known and Pr must be named or presently ascertainable so as to enable TP to identify Pr. The test is not whether Pr was in contemplation at the time of the contract.

— *Case example* —

Pr instructed A, a corn merchant, to purchase wheat from TP on a joint account at 45/3 per quarter. A could not buy at this price and decided to buy at 45/6 but did not disclose that he was acting for Pr. Pr purported to ratify. When the purchase price was not paid, TP sought to hold Pr to the contract. The action failed as it was held that the purported ratification was ineffective because A had not disclosed that he was acting for Pr.

— *Keighley, Maxsted & Co v Durant*²⁶ —

It follows that a contract made by a person who is supposedly acting on his own behalf, but with the undeclared intention of acting on behalf of

24. *Union Bank of Australia Ltd v Rudder* (1911) 13 CLR 152, per Griffith CJ at p 163.

25. (1889) 41 ChD 295, per Lindley LJ at p 309.

26. [1901] AC 240; [1900-03] All ER Rep 40.

a principal, cannot be ratified by that principal so as to give the principal rights under the contract. In the words of the High Court:

“I do not think that [Pr has] established that with respect to the whole of the bargain, which, as I have said, was a single bargain, [A] professed to be acting as an authorized agent for [Pr]. And, in my opinion, this is a necessary condition of the existence of any right of ratification in [Pr] within the rule laid down in *Keighley, Maxsted & Co v Durant*.”²⁷

(2) *The principal must exist at the time of the contract.* The Pr must exist at the time of the contract, or at least must be “anticipated” or in the mind of A even if not actually named — otherwise A runs the risk of being treated as Pr. Case law — *Kelner v Baxter* and *Black v Smallwood* (discussed at ¶11-290) — indicated that the company promoters (agents) could be personally liable in the absence of a Pr capable of ratifying the contract. The contractor will be liable in damages, unless exempted by the other party, if ratification does not occur within a reasonable time.

(3) *The principal must have the legal capacity to enter the contract.* A contract entered into on behalf of a minor will not bind the minor at common law (see ¶5-520).

(4) *Ratification must be within a reasonable time* according to the nature of the case and must certainly take place before the time fixed for the performance of the contract has expired.

(5) *A void contract cannot be ratified.* This point overlaps the comments made above at (2), namely, that if the contract is defective to start with, subsequent purported ratification will not make it good.

(6) *Forgeries.* A purported ratification will not have the effect of making a forged signature good, but a person who knows that his signature has been forged may be estopped from denying that it is genuine if he knowingly induces other parties to believe it to be genuine. See ¶16-380.

(7) *Ratification must be based on full knowledge of the material facts.*

(8) *Ratification must be complete.* The court will not allow ratification of only the advantageous parts of a contract.

(9) *Ratification can only be retrospective.* This means that a principal cannot advise the agent in advance that the principal will ratify all of the agent’s future contracts.

¶11-100 Authority of the agent. The agent’s authority may come from various sources:

- (1) it may be formally and expressly conferred in an instrument of appointment;
- (2) it may be conferred orally;

27. *Howard Smith and Co Ltd v Varawa*
(1907) 5 CLR 68, per Griffith CJ at p 82.

- (3) it may be implied by the conduct of the parties;
- (4) it may be inferred from the nature of the employment of the agent;
- (5) it may arise from necessity;
- (6) it may arise by a valid ratification by the principal after the event.

These sources of the agent's authority have been discussed in ¶11-050—¶11-090 above.

Authority of the agent may be classified in three ways:

- actual: ¶11-110;
- implied: ¶11-120;
- apparent or ostensible: ¶11-130.

Companies are principals of a non-physical kind, and the position of TPs dealing with company agents, and in particular the assumptions they are entitled to make in terms of reliance, are dealt with in Corporations Law sec 128-129, discussed at ¶9-470 and ¶11-130.

¶11-110 Actual authority. The most common role of A is to bring about a contract between Pr and TP based upon the actual or express appointment of A (¶11-050).

The actual authority of A consists of:

- (1) powers expressly given by Pr to A (¶11-050);
- (2) powers implied in the agency itself (¶11-060; ¶11-120);
- (3) powers which arise from necessity or by operation of law (¶11-070—¶11-080).

The actual authority of an agent includes contracting for Pr, making representations for which Pr will be responsible, receiving representations from TPs on behalf of Pr, making payments for Pr, and receiving moneys owing to Pr and giving a receipt.

¶11-120 Implied actual authority (between principal-agent). An agent also has authority to do anything which is incidental to or necessary for the carrying out of acts within A's actual authority (¶11-110). This is A's implied actual authority²⁸ arising between Pr and A, and it includes the extras necessary to fill in the gaps in the actual authority of the agency. It is often said to arise to give "business efficacy" where a contract may be silent:

- A manager of a shop (A) authorised to purchase stock, etc has implied actual authority to handle incidental matters like plumbing repairs and cleaning (even if not mentioned in the appointment).

28. Sometimes called incidental or customary authority.

- A real estate agent (acting for a vendor or landlord, ie A's principal) has implied actual authority to describe the property and to state any fact or circumstance which may affect the value so as to bind Pr, but a property manager does *not* have authority to enter into a lease on behalf of Pr without referring to Pr.²⁹
- A stockbroker instructed to buy shares has implied actual authority to act according to the exchange rules and usages of that exchange. Pr (the client) is taken to submit to the rules and usages of the exchange.³⁰

— *Case example* —

The Snowy Mountains Hydro case. A Belgian manufacturer of heavy electrical equipment (Pr) appointed an Australian company as its agent (A) to contract with the Snowy Mountains Hydro-Electric Authority (TP). The contract specified that the price was to be paid in Australia in Australian dollars as order cheques (¶16-250) payable to Pr care of its Australian A. A indorsed the cheques³¹ and paid them into its account with the bank. Some of the deposits were not forwarded to Pr by A, and when A went bankrupt Pr sued the bank, claiming it had no authority to bank its cheques into A's account.

The court held that as Pr had no bank account in Australia, A had implied actual authority to indorse cheques payable to Pr and to bank them into its account — especially where the amount of the cheques exceeded the then maximum that exchange controls allowed to be sent overseas. Pr was unable to recover from the bank for conversion (¶16-460) and its claim that A had no authority to bank the cheques failed.

A's authority to bank the cheques was both express actual authority (through the original agreement) and implied actual authority (to give "business efficacy" to the operation of the agency).

— *Australia and New Zealand Bank Ltd
v Ateliers de Constructions Electriques de Charleroi*³² —

Therefore actual authority may be impliedly created:

- (1) to give business efficacy to a business agreement;
- (2) based on existing custom or trade usage;
- (3) based on a consistent course of past dealings;
- (4) where Pr has held A out as having ostensible authority (see also ¶10-200ff);
- (5) where agency is presumed because of the operation of law, eg husband and wife (see ¶11-080);

29. *Showa Shoji Australia Pty Ltd v Oceanic Life Ltd* (1994) 34 NSWLR 548 at p 568.

30. eg *Mercantile Credits Ltd v Jarden Morgan Australia Ltd* (1990) 8 ACLC 431; Latimer, P, *Stock exchange usage* (1990) 8 C & SLJ 165; ¶6-120.

31. As was then required: ¶16-290; ¶16-510.

32. [1967] 1 AC 86; (1966) 39 ALJR 414 (PC).

- (6) where A acts in accordance with the usual authority of agents of that class;
- (7) where a person acts as agent of necessity (see ¶11-070).

¶11-130 Apparent or ostensible authority (effect on principal-third party). An agent may have apparent authority or ostensible authority to act on behalf of Pr or agency by estoppel — even though A does not have actual authority from Pr but only the appearance of authority.

— *Example: apparent authority* —

With the parent's agreement, a teenager may charge clothing to the parent's account which the parent pays. Unless the parent notifies the shop that future accounts will not be paid, the parent cannot deny the teenager's apparent authority to charge future purchases.

Apparent authority is an external matter affecting Pr/TP. A's action binds Pr because Pr has held out A as having authority to act for Pr.

Apparent authority can only arise if TP can establish that Pr acted in such a way as to lead TP to believe that Pr had authorised A's actions. If so, Pr is estopped from denying A's agency if TP relies on A's appearance of authority.

In contrast, if A has acted outside the scope of A's actual authority (¶11-110) or A's implied actual authority (¶11-120), Pr is not responsible for A's unauthorised transaction unless Pr's conduct has induced TP to contract with A in reliance on A's apparent authority.

— *Case examples* —

The Emu Inn, Parramatta. Laws (D) was the licensee of a hotel and his name was displayed over the door, but the proprietors of the business were Mr and Mrs Kinchela. Money for liquor sold and delivered to the proprietors was owing to Tooth and Co (P). Because P had no knowledge that the business was not that of D, D was estopped from denying that the Kinchelas were his agents for the purchase of the liquor. There was no evidence that P knew that the hotel was not owned and operated by D.

— *Tooth v Laws*³³ —

K (a property developer) and H formed a company, of which they were directors, to purchase and resell a large estate. Although the company's articles contained a power to appoint a managing director, none was appointed. In fact K acted as managing director, to the knowledge of the other directors of the company. In the course of business, K instructed the plaintiff architects to apply for planning permits and other related work and the question was whether K or the company was liable for the architects' fees. Held: although K had no actual authority to employ the architects, he did have apparent or ostensible authority such as would be within the usual

33. (1888) 9 LR (NSW) 154.

authority of a managing director, and the plaintiffs did not have to inquire whether he was properly appointed. It was sufficient that under the articles there was in fact power to appoint him as such. The company was therefore estopped from denying K's agency.

Four conditions which must be satisfied before a company can be bound by the act of an agent lacking actual authority were specified by *Diplock LJ*: "It must be shown: (a) that a representation that the agent had authority to enter on behalf of the company into a contract of the kind sought to be enforced was made to the contractor; (b) that such representation was made by a person or persons who had 'actual' authority to manage the business of the company either generally or in respect of those matters to which the contract relates; (c) that he (the contractor) was induced by such representation to enter into the contract, ie that he in fact relied on it; and (d) that under its memorandum or articles of association the company was not deprived of the capacity either to enter into a contract of the kind sought to be enforced or to delegate authority to enter into a contract of that kind to the agent."

— *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*³⁴ —

Diplock LJ's paragraph (b) in *Freeman & Lockyer*, above, is the important requirement for evidence of a representation of apparent authority, and it raises the question of who has actual authority to "hold out" a person as having authority.

— *Case example* —

The McWilliam family company had a board consisting of Bruce senior, his wife, Bruce junior and his wife. Peter, who had been a director until his bankruptcy, worked for the business full time but had no official title. On behalf of the company, Peter purported to accept a price quotation for the purchase of a printing press by signing a printed order form containing the printed signature of Bruce junior (at the time managing director) "per" Peter. Action was subsequently taken to enforce the contract by the vendor, and one defence advanced was to deny the existence of the contract on the basis that Peter lacked any authority to commit the company to this or any contract. The High Court confirmed that Bruce junior did not have actual authority to enter the contract (this was held by either the three-man management team or by the full board) and that Peter had no actual or apparent authority to so contract. Although Bruce junior had apparent authority under the company's constitution, he had not held Peter out as having apparent authority. This could only be done by the three-man management team or the full board. Therefore no contract had been made.

— *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising & Addressing Co Pty Ltd*³⁵ —

34. [1964] 2 QB 480 at p 506; [1964] 1 All ER 630 at p 646 (noted at ¶9-470).

35. (1975) 133 CLR 72; (1976) 50 ALJR 203; ¶11-340; noted, eg, *Corporations and securities law* (1976) 4 ABLR 70; *Commercial Law Note* (1976) 50 ALJ 253; *Legal Developments*, The Chartered

Accountant in Australia, March 1976, p 51; *Legal*, Australian Accountant, December 1976, p 707. Arguably the limitation exposed in this case has been overcome by Corporations Law sec 129(2) (¶9-470).

While at first appearing to be only an application of the *Freeman & Lockyer* principles, in fact paragraph (b) was not satisfied: even if Bruce junior had represented that Peter had authority, Bruce junior himself had no actual authority to make this representation. Only the three-man management team or the full board had actual authority to represent that Peter had apparent authority to contract. This case has often been criticised as being commercially unrealistic, because how could the third party know whether a person in Bruce junior's position had actual authority to make the paragraph (b) representation?

Section 129(2) of the Corporations Law (§9-470) provides some assistance to third parties in this situation, but still does not overcome the basic problem. Only if Bruce junior had been named in the company's register of directors, principal executive officers and secretaries, or in its annual return, could the third party assume when dealing with the company that Bruce junior had the powers customarily exercised by such person or apparent authority.

The customary powers or the apparent authority of company personnel is a matter governed by the common law.

— Case examples —

The apparent authority of the company secretary. Mr A was the company secretary of Pr Ltd (the principal). He ran up a large account in Pr's name with the plaintiff, a car hire operator, which specialised in the hire of executive cars like Rolls-Royces and Jaguars. When booking the cars, he stated they were for company use. In fact, he took delivery of cars and used them for his private use. The question was which of two innocent parties, the plaintiff or the principal, was to pay the loss. When Pr Ltd said that Mr A had no authority to bind it in contract, the court had to consider the apparent authority of a modern company secretary. In finding Pr Ltd liable for the actions of its agent, the court stated a very important principle applicable to the modern company secretary:

"A company secretary is a much more important person nowadays than he was in 1887 (the date of the earlier case on the point). He is an officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Acts, but also by the role which he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of the company's affairs, such as employing staff, and ordering cars, and so forth. All such matters now come within the ostensible authority of a company's secretary."

— *The Panorama Developments case*³⁶ —

36. *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971]

2 QB 711, per Lord Denning MR at pp 716-717.

A1 (an underwriting agent at Lloyd’s which managed a number of underwriting members), A2 (Lord Zouche, a commission agent of A1) and A3 (the managing director of A1) gave Lloyd’s membership application documents to TP. This of itself did not make them agents of Lloyd’s because none of them had actual authority from Lloyd’s and there was no representation of Lloyd’s by conduct or otherwise that they were its agents. Therefore they had no ostensible authority from Lloyd’s.

_____ *Williams v The Society of Lloyd’s*³⁷ —

The apparent authority of a bank manager. A, a “senior manager” of the Pr bank in charge of a branch office, negotiated bank credit to finance customer TP’s projects. When senior management of Pr at head office later decided not to proceed with the finance, TP sued Pr for breach of contract. The English Court of Appeal held that A’s letter to TP was an offer of finance which TP had accepted, and that although A did not have apparent authority to approve the finance, A did have apparent authority to communicate decisions and to sign letters on behalf of Pr (ie head office) including letters containing offers. By virtue of his position in the bank, A had apparent authority which committed Pr.

_____ *First Energy (UK) Ltd v Hungarian International Bank Ltd*³⁸ —

This case protects a TP who has dealt with A who has apparent authority, and upholds the reasonable expectations of the parties. It gives effect to common business practice between companies, enhances commercial certainty and reinforces the doctrine of apparent authority in protecting TPs who deal with companies unaware of secret limitations on the authority of A. It recognises that the corporation is responsible for its many agents, and that it would be unrealistic for a genuine TP to check the authority of each A or to inquire into the company’s internal controls on each A. As the judge stated in this case, if there had been judgment in favour of Pr (rather than TP), it would “fly in the face of the way in which in practice negotiations are concluded between trading banks and trading customers who seek commercial loans”.

DUTIES AND RIGHTS OF AGENT _____

Duties of the agent to the principal, or, rights of
the principal against the agent ¶11-140
Duty to follow the principal’s instructions ¶11-150
Duty to use reasonable diligence, care and skill ¶11-160
Duty to act in person/duty not to delegate ¶11-170
Duty to act in the principal’s interests ¶11-180
Duty not to divulge confidential information ¶11-190
Duty to keep accounts ¶11-200

37. [1994] 1 VR 274.

38. [1993] 2 Lloyd’s Rep 194, per *Steyn LJ*
at p 204, noted, eg, Brown, I, *The agent’s*

apparent authority: paradigm or paradox?
[1995] JBL 360.

Duties of the principal to the agent, or, rights of the agent against the principal	¶11-210
Agent's right to remuneration	¶11-220
Agent's right to indemnity	¶11-230
Agent's right of lien	¶11-240
Agent's right to stoppage <i>in transitu</i>	¶11-250

¶11-140 Duties of the agent to the principal, or, rights of the principal against the agent. The agency relationship is an example of a fiduciary relationship — the relationship of faithfulness or fidelity to another person discussed at ¶9-770.

As a fiduciary, an agent comes under duties and obligations which are expressly set out in the agency agreement as well as those implied by law. Breach of the agent's fiduciary duties may lead to liability of the agent to the principal for remedies including damages for breach of contract.

The duties of A to Pr are:

- (1) to follow the principal's instructions (¶11-150);
- (2) to use reasonable diligence, care and skill (¶11-160);
- (3) to act in person (¶11-170);
- (4) to act in the principal's interests (¶11-180);
- (5) not to divulge confidential information (¶11-190);
- (6) to keep Pr's moneys separate, to keep accounts and to be ready to account for those moneys when required (¶11-200).

¶11-150 Duty to follow the principal's instructions. If A agrees to effect a contract for Pr and does not effect the contract as agreed, there is breach of the contract between them and A will be liable in damages to Pr.

— *Case example* —

A was a broker instructed by Pr to sell stock when the market price reached a certain figure per unit of stock. A failed to sell at this price but held on to the stock and when the market dropped A was forced to sell for less. Pr sued to recover the difference.

— *Bertram, Armstrong & Co v Godfray*³⁹ —

A solicitor must also act only on the client's instructions. Hence, in the absence of actual authority, a solicitor (A) does not have authority to vary a client's (Pr's) contract, and the mere fact that a person is a solicitor confers no implied authority on that person to make contracts for a client.⁴⁰

39. (1830) 1 Knapp 381; 12 ER 364.

40. *Nowrani Pty Ltd v Brown* [1989] 2 Qd R 582.

If Pr's instructions seem to A to be ambiguous, A may be liable in negligence if A does not clarify what was meant. If the instructions seem clear to A and A acts on a genuine understanding of them, Pr may be bound.⁴¹

A's duty to follow Pr's instructions applies equally to insurance agents and brokers (§17-560).

¶11-160 Duty to use reasonable diligence, care and skill.

An agent is under a duty to carry out its agency with reasonable diligence, care and skill. This arises from an implied term of the principal/agent contract (§16-100), the ever-evolving law of negligence (§4-240, §4-250) and, if applicable, the warranties of "due care and skill" and fitness for purpose in relation to the supply of services implied by the *Trade Practices Act 1974* (Cth) and *Fair Trading Act* equivalents in some jurisdictions (§7-095).

The standard applicable is what a reasonable person would expect an agent of the type in question to exercise in the circumstances. Any failings, shortcomings or mistakes made by an agent will, depending on the circumstances, be actionable.

An agent will not be liable for negligence if it is sure of the correctness of its information or advice, or, if not, if it refers to the principal to verify the facts in question and if it accurately relays the facts.

An agent which does not have the relevant information merely has to say so, and can avoid liability by honestly stating the limits of its knowledge.

— Case example —

The water bore. A stock and station agent was held liable to the purchasers of a farm for its negligent mis-statements overstating the capacity and life expectancy of a water bore used on the farm for crop irrigation and grazing. The incorrect information was given to the agent by the vendor. The agent argued that the purchasers should have made their own inquiries about the bore, and that they could not rely on the agent. The New South Wales Court of Appeal rejected the agent's defence that it was merely passing on information supplied by the vendor. The agent was held liable because of its working knowledge of bores in the area and because of its awareness of the purchasers' lack of knowledge about bores, the purchasers' tight budget and the serious consequences that would flow from passing on incorrect information. The agent could have avoided liability for negligence by extinguishing the purchasers' reliance — by honestly stating that the bore figures were unverified and came from the vendor, or by suggesting that the purchasers should verify the figures themselves.

— *Rawlinson & Brown Pty Ltd v Witham*⁴² —

¶11-170 Duty to act in person/duty not to delegate. A must act personally when contracted with by Pr for the performance of

41. *Veljkovic v Vrybergen* [1985] VR 419.

42. (1995) Aust Torts Reports ¶81-341; ¶4-260; *Lee v Beyrouthy* (1994) ATPR

(Digest) ¶46-118 (liability of selling real estate agents to vendors for obtaining their agreement to option by misrepresentations).

services on Pr's behalf. The basis of this rule lies in the need to uphold the personal qualities of the agent which had influenced A's appointment in the first place. In other words, a principal is entitled to rely on and receive the benefit of the skill and knowledge of the agent Pr has appointed.

— *Case example* —

Pr appointed A, a firm of real estate agents, to sell his flat. Without Pr's knowledge or permission, A gave the details to a sub-agent, S-A. When S-A sold the property, it was held that A was entitled to no commission from Pr even though A had been instrumental in arranging the sale. Personal skill and competence were held to be important qualities which could not be delegated.

— *John McCann & Co v Pow*⁴³ —

However, three issues arise from the duty to act in person:

- (1) A power may be delegated where there is express or implied authority to delegate, such as by professional or trade usage (§16-120). Some statutes give certain classes of agent statutory powers of delegation.⁴⁴
- (2) Authority to delegate may be implied for purely ministerial acts, such as the signing of a letter or giving of a notice, if no personal confidence is placed in A by Pr, or if no special "personal" skill of A is required.
- (3) Although a solicitor, accountant, etc may delegate a task to, say, a junior clerk, responsibility for the task has not been delegated because whatever is done is still being done by, on behalf of and in the name of the originally appointed professional agent.

¶11-180 Duty to act in the principal's interests. A is under a duty to act in Pr's interests, and no private interest should ever conflict with this overriding duty. A must give Pr's interests priority over A's own, and must disclose anything A knows which might affect Pr's judgment. Even if Pr is not prejudiced by A in disregard of this duty, Pr can still sue — at common law or under the *Trade Practices Act 1974* (Cth) and *State/Territory Fair Trading Act* equivalents for misleading or deceptive conduct, including representations as to future matters (sec 52 and 51A: ¶7-250—¶7-287) and for false representations (sec 53: ¶7-290—¶7-395) — for damages arising from the loss of the trust and confidence placed by Pr in A. Acting in Pr's interests has at least two aspects:

- (1) *No conflict of duty.* An agent is a fiduciary who is to act in the interests of Pr (¶9-770, ¶10-370). Because Pr places trust and confidence in A, A must not be involved in a conflict of duty and interest.

43. [1975] 1 All ER 129.

44. eg *Trustee Act 1925* (NSW) sec 53, 55; *Trusts Act 1973* (Qld) sec 54; *Trustees Act 1962* (WA) sec 53.

— *Case examples* —

A stockbroker was involved in active undisclosed purchase and sale of shares on his own account as principal with his clients through his house account. This was soundly criticised in the following words:

“... Both Mr Hewson and the Stock Exchange have, throughout the events leading up to this litigation and throughout the litigation itself, proceeded on the basis that there is no impropriety in a sharebroker carrying on also a business as a sharetrader. This cannot be permitted to pass without critical comment. The primary function of a sharebroker is to advise clients and to act on their behalf in the purchase and sale of shares. He occupies a position which imposes on him important obligations toward his client. This is recognized by the stock exchange itself, within whose articles and bylaws are provisions directed towards requiring proper standards of integrity to be observed by brokers. A fundamental principle of commercial morality will be gravely compromised if brokers are permitted to enter the market and to trade not *for* their clients but *in competition with* them. The words of Lord Cairns LC in *Parker v McKenna* (1874) LR 10 Ch App 96 are as true today as they were in 1874: ‘Now, the rule of this Court, as I understand it, as to agents, is not a technical or arbitrary rule. It is a rule founded upon the highest and truest principles of morality. No man can in this Court, acting as an agent, be allowed to put himself into a position in which his interest and his duty will be in conflict.’”

*Hewson v Sydney Stock Exchange Ltd*⁴⁵ —

Conflict of duty. A buyer commissioned a real estate agent to find an investment property. Without disclosing his connection, the agent recommended a property owned by his father and brother, which he had been commissioned to sell. The buyer purchased the property. Later the buyer rescinded the contract when he learned of the agent’s conflict of interest — to the buyer and to the vendor. An agent must disclose to the buyer that it is also acting for the vendor and obtain the buyer’s consent to its acting for two principals.

*Lintrose Nominees Pty Ltd v King*⁴⁶ —

Where there is a danger of any conflict of interests caused by A’s personal interest, by law, ethics and by the ethical rulings of some professional associations, A must make full disclosure to Pr and obtain Pr’s informed consent, or A should decline to act as agent. Conflict may involve A’s acting as agent for two principals with conflicting interests. It may involve a broker or investment adviser accepting an undisclosed commission from a company for recommending it to clients.

45. (1967) 87 WN (NSW) 422 at p 425, documented in the Rae Report (1974) (¶13-400), and since regulated by statute with the need for disclosure and client consent both before the principal trade, and after it in the contract note:

Corporations Law sec 843; Aitken, M and Latimer, P, *Principal trading by stockbrokers* (1995) 5 Aust Jnl of Corp Law 1.

46. [1995] 1 VR 575 (Court of Appeal, Vic).

Breach of this duty renders A liable to Pr including liability for any secret profit or improper advantage received.

(2) *No secret profit.* A secret profit made by A at the expense of Pr is recoverable at common law.⁴⁷ For example, where A himself purchases an item for Pr and then sells it to Pr at a profit, the mark-up is recoverable.

— *Case example* —

Pr, a real estate buyer instructed A, a dealer in land and houses, to find her a property suitable for conversion into flats. A found a suitable property for £2,000 which he bought in his brother-in-law's name. In evidence, the brother-in-law stated that he had no ownership of the property and did not pay any of the price. A bogus or fictitious transfer of the property then took place to A at £4,500. As the new owner, A then offered the property to Pr at £5,000 which Pr accepted. When the truth was revealed, Pr successfully claimed the profit made by A as a refund. A's defence that the agency was terminated when A disclosed that he was the seller, and that he was free to sell without disclosure, was rejected.

Regier v Campbell-Stuart⁴⁸ —

The obligation to act in Pr's interests and to disclose all material facts is absolute. If A is proposing to sell property to Pr, A is bound to give Pr the fullest possible information including the price to A. Whatever profit finds its way into A's hands becomes a debt to Pr, recoverable by Pr. In addition, the contract in question can be rescinded at the instance of Pr with a consequent refund of moneys.⁴⁹

Secret commissions. In addition to these case law rules, legislation at the Commonwealth level,⁵⁰ and in each State and Territory⁵¹ prohibits agents from benefiting from secret commissions.

Section 4 of the *Secret Commissions Act 1905* (Cth) makes it an indictable offence for any person who without the full knowledge and consent of the principal directly or indirectly:

- “(a) being an agent of the principal accepts or obtains or agrees or offers to accept or obtain from any person for himself or for any person other than the principal; or
- (b) gives or agrees to give or offers to an agent of the principal or to any person at the request of an agent of the principal;

47. *Mahesan v Malaysia Government Officers' Co-operative Housing Society Ltd* [1978] 2 All ER 405 at p 408 (PC).

48. [1939] 1 Ch 766; [1939] 3 All ER 235.

49. eg *Boardman v Phipps* [1967] AC 46; *Green and Clara Pty Ltd v Bestobell Industries Pty Ltd* [1982] WAR 1.

50. *Secret Commissions Act 1905* (Cth).

51. eg Vic: *Crimes Act 1958* sec 175ff; *Estate Agents Act 1980* sec 56 (“Certain commissions illegal”). NSW: *Crimes Act 1900* Pt 4A. SA: *Secret Commissions Prohibition Act 1920*. Qld: *Criminal Code 1995 Chapter 42A*. WA: *Criminal Code 1913* sec 529ff. Tas: *Criminal Code 1924* sec 266. ACT: *Agents Act 1968* sec 72, 73. NT: *Criminal Code Act 1983* sec 236, 237.

any gift or consideration as an inducement or reward:

- (i) for any act done or to be done, or any forbearance observed or to be observed, or any favour or disfavour shown or to be shown, in relation to the principal's affairs or business, or on the principal's behalf; or
- (ii) for obtaining or having obtained or aiding or having aided to obtain for any person an agency or contract for or with the principal".

Breach of sec 4 can lead to a penalty of \$2,000 (for a corporation) or \$1,000 or two years' imprisonment or both (for any other person).

The *Secret Commissions Act 1905* (Cth) also makes it an offence for a third person to give an agent, or for an agent to receive or use, any "false, erroneous, or defective" receipt, account or document which is likely to mislead the principal (sec 5). The penalty is the same as for sec 4 above.

Section 6 makes it an offence for an agent (or for any firm or company of the agent) to buy from or sell to itself without the full knowledge and consent of the principal. The penalty is the same as for sec 4 above.

The principal may recover the amount of any secret gift or consideration given in breach of the Act either from the agent or from the person who gave it, whether or not the agent has been convicted or acquitted (sec 7), and it is no defence to show that any such gift or consideration is "customary in any trade or calling". The rule of evidence that a person is protected from disclosure on the grounds of the privilege against self-incrimination and that the prosecution must prove its case is excluded by sec 8 of the Act.

The Act provides that whoever aids or abets the commission of an offence under the Act is deemed to have committed the offence (sec 10).

Evidence is not admissible to show that the gift or consideration is customary in any trade or calling (sec 9).

Secret commissions: remedies of principal. In addition to the remedies of Pr to commence criminal proceedings as set out in the secret commissions legislation above, Pr may:

- (1) recover the secret commission from A in an action for restitution (¶6-510);
- (2) refuse to pay any commission to A, or, if any commission has been paid to A, recover it from A;
- (3) cancel the agency and dismiss A immediately;
- (4) sue A and TP jointly for the torts of conspiracy to defraud and/or deceit (¶5-700);
- (5) repudiate the contract with TP who paid the secret commission.

¶11-190 Duty not to divulge confidential information. From the duty to act in Pr's interests follows the duty of confidentiality. It may also be called a duty of secrecy and applies in many business relationships: solicitor/client, accountant/client, bank/client. In essence, the duty is not to

¶11-190

misuse confidential information, which of course is information concerning Pr entrusted to A for the use of Pr.

— *Case example* —

A Sydney solicitor controlled a number of companies (one of which was DPC Estates Pty Ltd) involved in house renovation and resale. Grey was the manager of the companies under a contract which included the undertaking not to divulge “any information concerning the business or finance of the company” and that he would not “be concerned ... in the business of real estate”. Unknown to the solicitor, Grey gave property information to Clowes, the solicitor’s articled clerk, who used it to enable his family’s investment company, Consul Development Pty Ltd, to buy some properties originally found for DPC. Under this arrangement Consul and Grey would share any profit or loss. When the solicitor learned of this arrangement behind his back in his own office, he unsuccessfully sued for declarations that the properties were held by Consul on trust for DPC. He was unsuccessful because it could not be shown that Consul, through Clowes, had actual knowledge of Grey’s breach of fiduciary duty to DPC (¶9-770) in buying for himself properties suitable for purchase by DPC — it was not certain whether Clowes had actual knowledge of Grey’s breach of fiduciary duty or impropriety. Therefore application for injunctions restraining Consul from dealing in the properties, and an account of profits from Grey and Consul, was unsuccessful.

————— *Consul Development Pty Ltd v DPC Estates Pty Ltd*⁵² ———

This case provides a clear analysis of the effect of a breach of confidence, or disclosure of confidential information, by an employee like Grey (¶3-685). It also confirms that a third party is accountable for a benefit which it takes if it knows of a breach of fiduciary duty owed by two other parties (though this was not proved in the case). This case was applied in the *Dickson Hotel case* (¶9-140) where breach of fiduciary duty between joint venturers led to profit to a third party (a company controlled by the person in breach of fiduciary duty). The company was held accountable to the innocent joint venturer because it had actual knowledge of the breach of fiduciary duty — since the joint venturer in breach was the mind of the company.

¶11-200 Duty to keep accounts. Proper accounts must be maintained by A whether expressly agreed to or not. This is a strict rule and it leads to the proposition that if A improperly mixes Pr’s property with his own so that he cannot separate the mix, the law presumes that the lot belongs to Pr. In other words, the law presumes A to be a trustee of Pr’s property and accordingly accountable to Pr.

The purpose of keeping proper accounts, of course, is that A can accurately and properly account to Pr for the money involved in A’s transactions on Pr’s behalf. In the case of professional agents, such as solicitors, accountants, stockbrokers, real estate agents and travel agents, legislation

52. (1975) 132 CLR 373; (1975) 49 ALJR 74.

makes this common law principle even clearer (for travel agents see ¶11-390, for real estate agents, ¶11-410ff).

Moreover, the rules on accounts apply even if the transaction by A was illegal: hence, if A is employed to place bets for Pr, any winnings A receives must be paid over to Pr; otherwise A can be sued by Pr for money had and received.⁵³

¶11-210 Duties of the principal to the agent, or, rights of the agent against the principal. The agent has many legal rights against Pr — including those arising under the express or implied terms of the agency contract — for remuneration (¶11-220), indemnity for expenses incurred (¶11-230) and to exercise a lien (¶11-240). These rights may be excluded (¶6-180).

In addition, conduct of Pr that can be defined as “misleading or deceptive” can be litigated by A under sec 52 of the *Trade Practices Act 1974* (Cth) and *Fair Trading Act* equivalents in all jurisdictions (¶7-250), as the Act “provides a remedy when all common law claims fail.”⁵⁴ To attempt to exclude A’s rights under the *Trade Practices Act* may also be “misleading or deceptive”.

¶11-220 Agent’s right to remuneration. The amount of remuneration or commission to which A is entitled will depend on the agreement with Pr. In some commercial situations (eg involving solicitors, stockbrokers, real estate agents) a percentage scale fee is recommended by a professional association (but is not compulsory: ¶8-660).

The agent must establish the following three matters before it can claim remuneration from Pr:¹

- that Pr had agreed to pay commission to A;
- that A had done what was required to earn the commission, and
- that A had been properly appointed (¶11-050).

— *Case example* —

A was appointed agent for the sale of a cinema. A did introduce a purchaser who offered the asking price, but no contract was ever made because Pr decided against proceeding with the sale. When A sued for A’s commission, A recognised that commission was payable on completion of the sale but in effect A was asking the court for a declaration that a term should be implied into the contract to the effect that Pr would not refuse to go ahead with the sale. It was held that no such term could be implied and that as

53. *Bousfield v Wilson* (1846) 16 LJ (Exchequer of Pleas) 44; *De Mattos v Benjamin* (1894) 63 LJQB 248.

54. eg *Colliers Jardine (NSW) Pty Ltd v Balog Investments Pty Ltd* (1995) ATPR (Digest) ¶46-140 (A entitled to damages

in lieu of commission), noted Pengilly, W, *Non-disclosure in agency agreements* (1995) TPLB 105.

1. eg *Salamon Nominees Pty Ltd v Moneywood Pty Ltd* (1999) ANZ ConvR 580 at p 585 (Court of Appeal, Qld).

a result no commission was payable; nor was Pr liable in damages for breach of contract.

— *Luxor (Eastbourne) Ltd v Cooper*² —

To overcome this principle, clear and unambiguous words would have to be used if the commission were to be payable without an actual sale taking place. This will be the case if the agreement specifies that commission is payable if the agent finds a buyer who is “ready, willing and able to purchase the property”, but commission will not be payable if a person is introduced prepared to purchase subject to finance and subject to the drawing up of a contract by solicitors. This clause requires an unconditional offer, even though it may not have been accepted and could be withdrawn.³

— *Case examples* —

Agent X, with whom a property had been listed for sale, showed the property to TP. TP made an offer through X which was rejected, and contact between TP and X lapsed. The property was also listed with agent Y, who also showed it to TP (Y not knowing that he had already inspected it). Y conducted the negotiations which led to purchase by TP. Agent X claimed for commission on the basis that X procured the sale, or that X’s efforts were the effective cause of the sale. This view was rejected because the intervention of Agent Y was necessary to clinch the sale.

— *Berben v Hedditch*⁴ —

The agency contract between Pr and A stated that A’s commission was payable on completion of the sale. The court held that as the contract indicated that the proceeds of the sale were to be the source of A’s commission, no commission was payable to A if the sale did not go ahead. However, to uphold equity between Pr and A, the court allowed a small payment to A on the basis of restitution: ¶6-510.

— *New South Wales Land and Housing Corporation v Sydneywide Real Estate Co Pty Ltd*⁵ —

There is a further factor important in the real estate agent context. In most jurisdictions, A will be debarred by statute from suing for commission unless A is a licensed agent and is appointed in writing.⁶ In the insurance context, see ¶17-580.

2. [1941] AC 108; [1941] 1 All ER 33.

3. *Watters v John Crisp Pty Ltd* (1982) 64 FLR 299.

4. (1982) NSW ConvR ¶155-081, per *Moffitt* P at p 56,479.

5. (1999) ANZ ConvR 68.

6. eg *Property, Stock and Business Agents Act 1941* (NSW) sec 20, 42AA; *Estate Agents Act 1980* (Vic) sec 50; *Land Agents*

Act 1994 (SA) sec 6; *Auctioneers and Agents Act 1971* (Qld) sec 76(1); *Real Estate and Business Agents Act 1978* (WA) sec 60; *Auctioneers and Estate Agents Act 1959* (Tas) sec 25, 31; *Agents Act 1968* (ACT) sec 18, 19, 116. See also *Fridman, GHL, The Law of Agency*, London, Butterworths, 7th ed, 1996, Ch 9, Appendix (“Estate Agent’s Commission”).

¶11-230 Agent’s right to indemnity. While acting for Pr, A may incur certain liabilities or make payments on behalf of Pr. In these circumstances, A will be entitled, by common law principles, to be indemnified against such liabilities or to recover any amounts paid. The key word here is “lawfully” — A must have lawfully incurred the loss or liability in question, and if A has acted outside the scope of A’s authority, or if A has suffered loss through A’s negligence or default, A will not be entitled to indemnity.

A can enforce this right of action by exercising a lien over Pr’s property until the amount is paid, or, if A is sued by Pr, A can counter-claim for the amount in question.

¶11-240 Agent’s right of lien. It follows from the previous point that where Pr is in debt to A, A may retain Pr’s goods or property which are in A’s lawful possession if Pr has not satisfied his liabilities to A. Such a lien entitles A to retain the goods in question until the debt due is satisfied.

Liens are of two types:

- A general lien (see ¶13-240—¶13-250), under which A may retain goods of Pr even though Pr does not owe A anything in respect of those specific items. This means that any documents, keys, etc held by A in respect of other transactions could be withheld — this is a dramatic gesture, and the law does not favour general liens. Indeed, they will only be enforceable in two circumstances, namely, where there is express agreement between the parties, or where there is a judicially recognised usage (as in the case of solicitors and bankers).
- A particular lien, under which A is only entitled to retain a particular item until Pr pays A what is owing on it.⁷ In other words, the transaction in issue relates to the specific property over which the lien is exercised (key to the house in issue, for example). See further ¶13-250.

¶11-250 Agent’s right to stoppage *in transitu*. In some purchase situations where A becomes personally liable for the purchase price and where ownership of the goods in question passes to A, A can exercise the right of stoppage *in transitu*, so called, against the goods if Pr does not pay for the goods. It may be said, then: no money, no goods.

LIABILITIES IN AGENCY LAW _____

Who can sue and be sued? ¶11-260

Agent’s liability: agent contracts personally ¶11-270

Agent’s liability: circumstances show that agent
intended to contract personally ¶11-280

Agent contracts on behalf of non-existent principal:
agent contracts personally ¶11-290

7. eg *Re Clune* (1989) 7 ACLC 1.

Agent executes a deed:	
agent personally liable	¶11-300
Agent acts for foreign principal:	
agent may act personally	¶11-310
Agent signs bill of exchange or cheque:	
agent acts personally	¶11-320
Agent liable for breach of warranty of authority	¶11-330
Doctrine of the undisclosed principal	¶11-340
Undisclosed principal: limitation of rights	¶11-350

¶11-260 Who can sue and be sued? As the agent is really only a conduit between Pr and TP, A does not face legal liability to TP or Pr in the ordinary course of events. After Pr's transaction is completed with TP, A retires from the transaction and at that stage the only parties with rights under that transaction are Pr and TP.

Liability of principal on the contract. The contract having been made by A on behalf of Pr, Pr has the normal rights and liabilities of a party to a contract to sue and be sued. After all, A has contracted on P's behalf and A will not generally be liable on the contract, nor will A be entitled to sue on the Pr/TP contract.

Liability of agent on the contract. By the very nature of agency, A is excluded from liability on the Pr/TP contract. But if it is not a "true" Pr/TP contract, A can face liability; and this can happen in a number of circumstances, set out in ¶11-270—¶11-330 below.

The principal is not liable for the actions (including misrepresentation, or misleading or deceptive conduct) of A in the period before A's appointment as agent.⁸

¶11-270 Agent's liability: agent contracts personally. Failure by A to make clear the status of agency — that A is only a conduit — may lead to A incurring liability as a signatory to the contract. The law seeks to determine liability by consideration of the intention of the parties as expressed in the whole of the agreement, and proof of the assent in the signature.⁹ But just signing "as agent" may be insufficient unless A makes clear that the contract is really with Pr. It is especially doubtful whether this precaution can work in an oral contract.

8. *SPA Property and Investments Co Pty Ltd v Pembroke Antiques Pty Ltd*, unreported, Supreme Court, Qld, Court of Appeal, 17 December 1992; digested [1994] ACL Rep 15 QLD 1; criticised Callinan, IDF and Howe, KS, *When is an agent an agent?* (1995) 69 ALJ 180.

9. *Universal Steam Navigation Co Ltd v James McKelvie & Co* [1923] AC 492 at pp 499-500; Curtis, CD, "Signer Beware! — the liability of the signatory to a contract" (1987) 3 Aust Bar Rev 65.

— *Case example* —

A tenant was authorised by his landlord to have work done on the driveway of the rented premises. Although it was clear that it was the landlord who had authorised the work, it was held that A (the tenant) was personally liable because this could be inferred from the overall circumstances.

— *Cooper v Fiske*¹⁰ —

What, then, must A do to ensure that A will not be liable on the contract? Given circumstances where the terms of the contract do not involve liability of A, any of the following may provide further evidence of A's status:

- A signs "for Pr".
- A signs the contract "as agents to merchants"¹¹ — A is not liable.
- A signs with "agent" after the signature.
- The contract states "order given through A of Sydney for Pr of Quebec" and the signature of A is followed by "agent for" Pr.
- A contracts to sell item "belonging to Pr" — A is liable.
- A contracts to sell item "on account of Pr" — A is not liable.

¶11-280 Agent's liability: circumstances show that agent intended to contract personally. There are a number of circumstances where it can be shown that A in fact intended to be personally liable. Where A undertakes personal liability to TP in the course of acting for Pr, A will be liable for any contractual undertaking he makes. Custom and trade usage (¶6-120) may indicate that A contracts personally.

- *Stock Exchange*. Stock Exchange rules provide that in contracts between brokers, the parties shall be deemed to be principals to each other.¹²
- *Agent's liability in tort*. Legal requirements of a normal duty of care cannot necessarily be transferred to Pr if it can be shown that the duty of care was that of A personally.¹³
- *Auctioneers*. Although agents of their vendors, auctioneers do warrant that they at least have authority to sell on behalf of their vendor/principal.

¶11-290 Agent contracts on behalf of non-existent principal: agent contracts personally. This issue can easily arise in the context

10. (1912) 18 ALR 155; 33 ALT 231.

11. *Hutchinson v Tatham* (1873) 8 LRCP 432, cited in *Marsh & McLennan Pty Ltd v Stanyers Transport Pty Ltd* (1993) 7 ANZ Insurance Cases ¶61-203 at p 78,341.

12. *Australian Stock Exchange Ltd*, Business Rule 2.19 (Contracts between clearing participants).

13. *Fairline Shipping Corporation v Adamson* [1975] QB 180.

of a contract made by the promoters of a company which has not yet been incorporated. If the company's incorporation is not yet complete, and if a contract has been made by persons as "directors" or "agents" of the company to be formed, can they be deemed to be contracting on their own behalf (or personally) just because the company does not yet exist?

— *Case example* —

In the leading case, an offer was accepted as follows:

"Sir, we have received your offer to sell the extra stock as above, and hereby agree to and accept the terms proposed.

Signed JD Baxter
NJ Callisher
J Dales

On behalf of the proposed Gravesend
Royal Alexandra Hotel Co Ltd."

After the Hotel was incorporated, the company purported to ratify this arrangement, but was unsuccessful on the basis that when the arrangement was made there was no principal. However, the contract was held to be enforceable against the promoters personally.

— *Kelner v Baxter*¹⁴ —

In this case the company itself could not be made liable (as the ratification was ineffective), but the surrounding circumstances were sufficient to show that the contract was made by the individuals personally. This was because the form of the signature and the surrounding circumstances indicated that the intention of the parties (Baxter, etc) was to contract in their own right. The company was not contracting because it did not yet exist. All parties knew that. The contract made it clear that the company was still only "proposed" and it could clearly not be considered to be a company contract, or, in other words, a contract entered into by agents to bind their principal. Section 131 of the Corporations Law allows ratification of pre-registration contracts, however, once the company has been incorporated. This ratification is subject to certain conditions, and must occur within a reasonable time or such other time as the parties agree. This section of the Corporations Law overrides the common law position established in *Kelner v Baxter* in so far as it concerns companies.

The following example seems similar, but on analysis is different because the form of the signature indicates that it was clearly a contract of Pr Pty Ltd. If this company did not exist at the time of the contract, there would be a non-existent principal. The agents (the directors) were not liable because the signature indicated that the contract was being made with the company or else with nobody.

14. (1866) LR 2 CP 174; [1861-73] All ER Rep Ext 2009; see also ¶11-090 and ¶9-400.

— *Case example* —

A company entered a contract for the sale of land as purchaser and signed the contract as follows:

Pr Pty Ltd

Y }
Z } Directors

It was later discovered that Pr Pty Ltd had not been formally incorporated at the date the contract was signed, although Y and Z believed that it had and that they were its directors. When the vendors sought to enforce the contract, it was alleged that, as the contract was one entered into by Y and Z on behalf of a company to be formed, there was a personal obligation to fulfil the terms of the contract. It was held that the signature did not give rise to the inference that Y and Z intended personal liability. There was no evidence of such intention on the part of Y and Z and, as the only signature appearing on the contract was that of a non-existent company, no one could be liable.

*Black v Smallwood*¹⁵ —

¶11-300 Agent executes a deed: agent personally liable.

At common law, an agent must have been appointed and empowered by deed (such as a power of attorney) to be able to execute and deliver a deed on behalf of Pr, otherwise A will be personally liable on the deed (even if described in the deed as acting for a named Pr). This rule has been modified in some jurisdictions,¹⁶ and has been modified in relation to companies.¹⁷

¶11-310 Agent acts for foreign principal: agent may act personally.

An earlier view used to be that where an agent contracted on behalf of a foreign principal there was a presumption that the agent alone could sue and be sued on the contract. In other words, it was held that A would be solely responsible on the basis that A could create no privity of contract between the foreign principal and a local TP. However, this presumption can be reversed.

Suing foreign defendants and enforcing judgments overseas can be difficult, so ideally the contract should provide that the agent (within the jurisdiction) of a foreign principal will be liable on the contract as principal.

¶11-320 Agent signs bill of exchange or cheque: agent acts personally.

If A's name appears on any bill of exchange, promissory note or cheque, A will be personally liable unless A makes it clear that A is acting in a representative capacity (¶16-340). The *Bills of Exchange Act 1909* (Cth) (sec 28, 97)/*Cheques Act 1986*(Cth) (sec 31) makes clear the position

15. (1966) 117 CLR 52; see also ¶11-090, ¶19-400.

The appointment of agents and attorneys to execute deeds (1989) 63 LIJ 1154.

16. eg *Property Law Act 1958* (Vic) sec 73B; see further Collier, B and Bradley, D,

17. *Corporations Law* sec 126.

that a person is liable on a bill or cheque by virtue of signing it. The legislation further states (sec 31/33) that where a person signs a bill or cheque, indicating that the person signs on behalf of a principal, or in a representative character, that person will not be personally liable, “but the mere addition to his signature of words describing him as an agent, or as filling a representative character, does not exempt him from personal liability”.

In other words, if A has authority to sign for Pr, A will negative A’s personal liability if A signs:

For Pr, A agent; or
per pro or pp Pr, A.

If A signs as “A, agent for P”, then the word “agent” may be regarded as descriptive only and A may be personally liable. As was said in 1816, A must make it clear that A is “the mere scribe”.¹⁸

¶11-330 Agent liable for breach of warranty of authority.

If A claims to be acting as an agent, but in fact has no authority to enter into the agreement in question, A can be sued by TP for the representation of authority made. To succeed in an action for breach of warranty of authority, TP must prove:

- that A claimed to have authority;
- that TP was induced to enter into the transaction because of this claim; and
- that TP would not have entered the transaction otherwise.

A solicitor (A) signing a contract on behalf of a client (Pr) must first obtain the client’s authority for the contract to bind Pr. If it is not binding, the solicitor may be liable to the other party to the contract for breach of warranty of authority even if A has signed the contract in the unfounded belief that the client would approve the signing.¹⁹

¶11-340 **Doctrine of the undisclosed principal.** A may act as an agent of Pr but not disclose this to TP — this means that A is acting for an undisclosed principal.²⁰ TP, unaware of the existence of Pr, thinks that it is dealing with A as a Pr. It may be possible for Pr to reveal Pr’s existence as A’s principal later, and enforce the contract. Under this rule known as the doctrine of the undisclosed principal, a person who is not obviously party to the contract (the undisclosed Pr) can sue and be sued in his own name on a contract entered on his behalf by his agent so long as A was acting *within authority*. By definition, TP at the time of contracting would have been

18. *Leadbitter v Farrow* (1816) 5 M & S 345; 105 ER 1077.

19. *Suleman v Shahsavari* [1988] 1 WLR 1181, noted (1989) 63 ALJ 421.

20. Distinguish the undisclosed principal from the unnamed principal, where TP is aware that A is an agent but does not know the identity of Pr.

unaware of the existence of the undisclosed Pr, and would not have known that the person with whom he was dealing was agent for someone else.

This rule is apparently inconsistent with the basic principle that only parties to a contract can acquire rights under it and it has been frequently criticised as unjust, unsound and anomalous. The generally accepted reason used to explain the rule is that “the contract is in truth, although not in form, that of the undisclosed principal”²¹ and by this fiction the undisclosed Pr can give effect to what is true in fact.

Other explanations have been advanced. In specific fact situations they may be applicable but are considered unreliable as generalisations:²²

- The undisclosed Pr is to be treated as beneficiary of contracts entered by Pr’s agent as trustee on Pr’s behalf.
- Where there is “benefit” to the undisclosed Pr or “reliance” to Pr’s detriment by the TP, the relationship is legally enforceable.
- The undisclosed Pr is an implied assignee of the agent.

The doctrine of the undisclosed principal is in fact narrowed by several requirements, and can fail to operate for any one or more of the following:

(1) An undisclosed Pr can sue or be sued on any contract made on its behalf by A acting within the scope of A’s authority. This doctrine assumes that A had actual authority at the time of contracting because if A lacks actual authority, undisclosed Pr cannot enforce the contract. Nor can undisclosed Pr ratify a contract supposedly made on its behalf if Pr is not named or identified (§11-090). Why then did the court enforce the following contract against the undisclosed Pr?

— *Case example* —

A hotel was run by the manager/licensee in his own name, with, for example, his name displayed over the door. He was, however, forbidden to buy cigars on credit by his principal, and when this was done, the question arose whether or not the undisclosed principal would be liable. The court said Pr would be liable because purchase of cigars on credit was clearly within the authority usually given to the manager of a hotel.

— *Watteau v Fenwick*²³ —

This decision has been widely criticised and is generally considered to be incorrect because:

1. The doctrine of the undisclosed principal does not apply where A had no actual or ostensible authority to contract on behalf of Pr.

21. *Keighley, Maxsted & Co v Durant* [1901] AC 240 at p 261.

22. Set out in Fridman, GHL, *The Law of Agency*, 7th ed, 1996. See further Greig, DW and Davis, JLR, *The Law of Contract*, The Law Book Co Ltd, 1987, pp 1001-1002; *Vital Finance Corporation*

Pty Ltd v Taylor (1993) ASC ¶56-205 at pp 58,179-58,182.

23. [1893] 1 QB 346; [1891-94] All ER Rep 897. Contrast *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising & Addressing Co Pty Ltd* (1975) 133 CLR 72; set out at ¶11-130.

2. Even if A had apparent authority, Pr cannot be liable unless Pr is named or identified.
3. There was no holding out by Pr that A had actual or apparent authority.

Perhaps this should really be seen as a case of apparent authority (rather than undisclosed principal) confirming that limitations placed upon apparent authority may be ineffective (unless known to TP) and the widening scope of apparent authority of A will certainly commit Pr (§11-130).

(2) Where A enters a contract in A's own name, evidence may be admissible to show the identity of the real Pr so that the real Pr can sue or be sued. Hence, if evidence as to the existence or identity of the undisclosed Pr is held inadmissible, the doctrine will not operate. For example, parol (oral) evidence may not be admitted to vary, contradict, add to or subtract from the words of a written contract (§5-030).

— *Case example* —

Where A had signed a charterparty as "owner" of a ship, it was held that the undisclosed Pr could not sue on that contract and that parol evidence was not admissible to show that A had signed on behalf of the undisclosed Pr.

— *Humble v Hunter*²⁴ —

(3) The rights of an undisclosed Pr to sue and be sued may be excluded if inconsistent with the terms of the contract. For example, if the contract involves matters personal to A, it cannot be enforced by undisclosed Pr. Or the identity of the person with whom TP is dealing may be crucial to the making of the contract.

— *Case examples* —

The managing director of the Palace Theatre had Mr Said, a critic of the theatre, barred from entry over earlier differences concerning allegations regarding the sale of tickets for one of the operas. Mr Said (Pr) had a friend (A) buy a ticket for him to use, but when still refused admission Pr sued the managing director (TP) for wrongfully inducing the owners of the theatre to commit breach of Pr's contract for admission to the theatre. The action against the managing director failed because there was no breach of contract in refusing Pr admission. Because of the personal element of the objection to Pr, the doctrine of the undisclosed principal could not apply to him.

— *Said v Buttr*²⁵ —

Principal bound by consent of undisclosed agent. Compafina, a Swiss bank (the undisclosed Pr), financing an Australian company (BTE) for the purchase of barley, employed the ANZ Bank as its agent. When some barley was shipped without the consent of the Swiss bank, it sued BTE and the ANZ Bank for alleged breach of an equitable pledge (§13-190) by releasing the barley without consent. The English Privy Council held that the warehouseman (Maynegrain) was accountable to BTE and to the ANZ

24. (1848) 12 QB 310; [1843-60] All ER Rep 648. 25. [1920] 3 KB 497; [1920] All ER Rep 232.

Bank (which, as undisclosed agent, was thought by M to be the Pr) but not to the undisclosed Pr.

————— *Maynegrain Pty Ltd v Compafina Bank*²⁶ ———

(4) TP can elect to sue Pr or A so long as the election is made in a reasonable time. Having elected, however, TP cannot have a change of mind and sue the other party. Once TP has judgment against A, TP cannot, without setting aside the judgment, sue undisclosed Pr even if Pr's existence was known to TP when judgment was obtained. There can only be one judgment for one debt, and the liability of undisclosed Pr merges in the judgment obtained by TP against A.²⁷

(5) If the undisclosed Pr intervenes and sues TP, A cannot sue or continue in any action he may have commenced.

(6) The doctrine cannot apply where A has contracted as Pr in A's own right: A will be personally liable if TP does not know of the *existence* of Pr. A is not personally liable if A contracts as an agent and the existence of Pr is known even if TP does not know the *identity* of Pr.²⁸

Because of the "odd" nature of the rule — a person apparently not party to the contract suddenly appearing over the horizon and suing on it — it must be seen as limited and tied down by these established principles.

¶11-350 Undisclosed principal: limitation of rights. Before deciding whether an undisclosed Pr has any rights, consider again these limitations.

- TP's option is limited in two ways:
 - (1) After election TP cannot have a change of mind.
 - (2) Once Pr and A have settled between themselves, TP cannot sue Pr on the contract.²⁹
- Pr's rights to intervene are limited in three ways:
 - (1) Because the undisclosed Pr is not identified, Pr cannot ratify unauthorised acts of A.³⁰

26. [1984] 1 NSWLR 258; (1984) 58 ALJR 389; discussed by Palmer, NE, *The vindication of commercial security over commodities: equitable pledges and conversion* [1986] LMCLQ 218.

27. *Marginson v Ian Potter & Co* (1976) 136 CLR 161. On the doctrine of election, see also *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corporation of India (The "Kanchenjunga")* [1990] 1 Lloyd's Rep 391 at p 397ff (HL), noted (1991) 65 ALJ 502.

28. eg *Marsh & McLennan Pty Ltd v Stanyers Transport Pty Ltd* (1993) 7 ANZ Insurance Cases ¶61-203 at p 78,342, noted (1994) 68 LIJ 497 (A, acting for an undisclosed Pr, not liable, because TP dealt with A as A of Pr. The only parties to the contract were TP and Pr).

29. *Thomson v Davenport* (1829) 9 B&C 78; 109 ER 30; *Armstrong v Stokes* (1872) LR 7 QB 598.

30. *Kelner v Baxter* (1866) LR 2 CP 174; see ¶11-090, ¶11-290.

- (2) If A has misrepresented that A is not an agent, Pr cannot intervene. TP's rights are against A.
- (3) If the contract is really made with A, not Pr (as discussed above, ¶11-270), undisclosed Pr cannot intervene.

TERMINATION OF AGENCY _____

Termination of agency by operation of law ¶11-360

Termination of agency by action of the parties ¶11-370

¶11-360 Termination of agency by operation of law. Agency is terminated by operation of law in several situations:

- (1) Death of A or Pr. Where A purports to contract on behalf of Pr after Pr's death there can be no contract except in certain limited cases because of the essentially personal nature of the agency relationship, even if Pr's estate wished to ratify the arrangement and even if A and TP were unaware of Pr's death. This would be an example of the problem of the non-existent Pr. However, Australian legislation relating to powers of attorney specifies that every act done in good faith within the scope of a power of attorney after the death of the donor and before receipt of notice thereof will be valid and the donee of the power will not be liable.³¹ The death of Pr does not terminate an irrevocable power conferred for a period extending beyond the lifetime of Pr (see below).
- (2) Mental incapacity, such as to render either Pr or A incapable of contracting personally.³²
- (3) Bankruptcy of either A or Pr, because a bankrupt has limited capacity to contract during bankruptcy (¶13-600).
- (4) Illegality of subject matter.
- (5) Circumstances that amount to frustration of contract, such as destruction of the subject matter or the happening of events which render performance of the agency unlawful (¶6-350).
- (6) Where Pr or A is a corporation, dissolution of the corporation terminates the agency (unless under an irrevocable power of attorney: see below).

A power of attorney will be enduring³³ or irrevocable if expressed to be irrevocable and if given for valuable consideration, and in particular it will

31. eg *Instruments Act 1958* (Vic) sec 110; *Conveyancing Act 1919* (NSW) sec 161; cf *Powers of Attorney Act 1998* (Qld) sec 19; *Registration of Deeds Act 1935* (SA) sec 35; *Property Law Act 1969* (WA) sec 85; *Powers of Attorney Act 1934* (Tas) sec 13; *Powers of Attorney Act 1980* (NT) sec 16(a).

32. eg *Conveyancing Act 1919* (NSW) Part 16 Div 2 (sec 163C-163H). Unsoundness of

mind, etc, inserted 1983; *Instruments Act 1958* (Vic) sec 114; *Property Law Act 1969* (WA) sec 86, 87; at common law, *Public Trustee v Nuttall* (1982) ANZ ConvR 476.

33. An "enduring power of attorney": ¶11-030.

not lapse or be revoked by the principal's death, bankruptcy or most of the other circumstances listed above.

¶11-370 Termination of agency by action of the parties.

The rights of the parties to end the contract will depend on the terms of the contract and, in the absence of any express provisions in the contract binding the parties, the contract can be ended at any time by the revocation of the principal or the renunciation of the agent. The contract of agency can be ended—

- by mutual agreement. Pr and A will be able to mutually agree to terminate the contract while it is still current.
- by complete performance of the contract. Where A is appointed for a specific purpose or act — eg to sell a house — A's agency will continue only until the purpose or act has been completed. One thorny problem in this context is whether Pr can terminate the agency by ceasing to carry on business and thereby escape the payment of further commission to A. The answer will depend on the express or implied terms of the agency agreement.³⁴
- by expiration of time.
- by dismissal following A's acceptance of a secret commission (see ¶11-180).
- by revocation of A's authority. There are important points to notice in this context. Pr can end A's real or apparent authority at any time, and no special formalities will be needed. But by revoking A's authority Pr may well break Pr's contract with A, in which case Pr may be liable to A for damages for wrongful dismissal and for loss of (expected) commission.³⁵ To avoid this problem, Pr must be sure to give A the notice specified in the contract of agency or, if no notice is specified, whatever notice seems reasonable in the circumstances. If a power of attorney has been revoked by Pr, powers of attorney legislation protects actions by A (acting within power and without notice)³⁶ and transactions of TP and claimants under TPs (relying on the power of attorney and the fact that A is supposedly acting within power, and without notice).³⁷ Powers of attorney may be irrevocable (¶11-360). If the contract of agency is for a sole or exclusive agency, Pr may still incur liability for commission to A if the property, eg real estate, is sold during the sole

34. eg *Turner v Goldsmith* [1891] 1 QB 544; [1891-94] All ER Rep 384; contrast *French & Co Ltd v Leeston Shipping Co Ltd* [1922] 1 AC 451; *Roberts v Elwells Engineers Ltd* [1972] 2 QB 586 [1972] 2 All ER 890.

35. "Any act on the part of [Pr] which would destroy the authority or impair its operation must be a breach of the conditions necessarily implied in granting an irrevocable authority exercisable

exclusively for the benefit of the persons authorized [A]." *Slatter v Railway Commissioners for New South Wales* (1931) 45 CLR 68 at p 78.

36. eg *Conveyancing Act 1919* (NSW) sec 161; *Instruments Act 1958* (Vic) sec 110; *quaere Property Law Act 1969* (WA) sec 85.

37. eg *Conveyancing Act 1919* (NSW) sec 162 (substituted in 1983); *Instruments Act 1958* (Vic) sec 110.

or exclusive agency period or if the property is later sold to a person introduced by A.

LICENSING OF PROFESSIONAL AGENTS _____

Statutory provisions	¶11-380
Travel agents	¶11-390
Real estate agents	¶11-410
Real estate agents legislation	¶11-420
Licensing of real estate agents	¶11-430
Real estate agent's authority	¶11-440

¶11-380 Statutory provisions. In addition to the general principles of agency law considered in this chapter, the operations of most “professional” agents are covered by specific occupational regulation legislation and/or the requirements of professional associations. These are largely consumer protection requirements designed to redress the supposed imbalance between the unskilled public and the knowledgeable professional by laying down educational and experience qualifications, and standards of ethical and good business practice. Such requirements also have the potential for negative, anti-competitive consequences, and must now be “authorised” by the Australian Competition and Consumer Commission (eg real estate agents, stockbrokers: ¶8-660).

The following “professional” agents are subject to statutory and/or professional association requirements:

- Accountant.³⁸
- Credit provider under the consumer credit legislation.³⁹
- Debt collector, commercial agent, commercial sub-agent (person who conducts a business collecting debts or repossessing goods under hire-purchase agreements for other people) and inquiry agent (person who undertakes activities such as searching for missing persons and obtaining information about a person's character or business).⁴⁰

38. Auditors and liquidators are registered under the Corporations Law; tax agents are registered under the *Income Tax Assessment Act 1936* (Cth).

39. The Consumer Credit Code does not deal with licensing, which is dealt with under State/Territory laws such as the *Credit Administration Act 1995* (SA): ¶14-270.

40. eg *Private Agents Act 1966* (Vic); *Commercial Agents and Private Inquiry Agents Act 1963* (NSW); *Auctioneers and Agents Act 1971* (Qld); *Security Providers Act 1993* (Qld); *Security and Investigation Agents Act 1995* (SA); *Commercial and Inquiry Agents Act 1974* (Tas); *Commercial and Private Agents Licensing Act 1979* (NT).

- Employment agent.⁴¹
- Factor or mercantile agent.⁴² This is the agent employed:

- (1) to sell goods or to consign goods for sale where Pr has entrusted the goods or documents of title to the factor's possession. The factor can sell the goods in its own name as if a Pr. TP can treat the factor as Pr, unless TP has notice to the contrary — for example, the factor may receive payment for the goods from TP, and TP would not have to repay Pr.

The authority of a factor to sell the goods “entrusted” to it, even if unauthorised, so as to pass good title to TP is an exception to the *nemo dat* rule (¶3-270). The owner (Pr), who leaves goods or documents of title with a factor, will be bound to TP by unauthorised dealing by the factor.

The Sale of Goods Acts recognise sale by a factor as an exception to the rule that only the owner can pass good title to goods: ¶17-020.⁴³

- (2) to buy goods or to raise money on the security of goods or of documents of title to goods.
- Finance or mortgage broker — the agent who negotiates loans with private and institutional lenders.⁴⁴
 - Futures broker and futures adviser.⁴⁵
 - Insurance agent. Registration is not required under the *Insurance (Agents and Brokers) Act 1984* (Cth), although sec 11 of that Act generally makes insurers liable for actions of insurance agents (see ¶17-540).
 - Insurance broker. Brokers must be registered under the *Insurance (Agents and Brokers) Act 1984* (Cth) (see ¶17-590).

41. Required to be licensed under, eg, *Employment Agents Act 1983* (Vic); *Employment Agents Act 1976* (WA).

42. *Goods Act 1958* (Vic) sec 65-72; *Factors (Mercantile Agents) Act 1923* (NSW); *Factors Act 1892* (Qld); *Mercantile Law Act 1936* (SA); *Law of Merchants Act Amendment Act 1842* (Imp), Imperial Act 5 and 6, Vic, c 39 and *Factors Act 1844* (WA); *Factors Act 1891* (Tas); *Mercantile Law Act 1962* (ACT) sec 4-11; *Mercantile Law Amendment Act 1861* (SA) applies in NT; ¶17-020.

43. eg *Sale of Goods Act 1923* (NSW) sec 26(2); 1896 (Tas); sec 26(2); 1954 (ACT) sec 26(2); 1972 (NT) sec 26(2).

44. eg *Credit (Finance Brokers) Act 1984* (NSW); *Finance Brokers Control Act*

1975 (WA), based on *Mortgage Brokers*, Report No 45 of the Law Reform Commission of Western Australia. The *Consumer Credit (Finance Brokers) Act 1998* (Vic) repealed the *Finance Brokers Act 1969* (Vic) and replaced it with new Pt 4A in the *Consumer Credit (Victoria) Act 1995*. The Act abolished the need for finance brokers to be licensed and replaced it with negative licensing by providing that certain people will be disqualified and prohibited from finance broking: see further CCH *Australian Consumer Credit Law Reporter* ¶150-557.

45. Corporations Law Chapter 8.

- Moneylender — legislation applies to personal moneylenders, finance companies, non-consumer lenders in Tasmania,⁴⁶ and pawnbrokers (¶13-220).
- Motor car trader — whether or not the trader acts as agent for the seller (as is sometimes the case) — there are strict licensing provisions for motor car traders in all States (see ¶7-510—¶7-640).
- Real estate agent (¶11-410—¶11-440).
- Settlement agent (WA) and land agent (SA).⁴⁷
- Solicitor.⁴⁸
- Stockbroker, sharebroker, dealer and investment adviser.⁴⁹
- Travel agent (¶11-390).

¶11-390 Travel agents. The travel industry is one important practical area of modern agency law. Travel agents are regarded by the law as agents of their principals, whose products they sell, such as airlines, shipping companies and hotels. For providing these services, travel agents receive a commission on sales.¹

In some circumstances, travel agents may also be agents of their clients if they are appointed to act on their behalf in meeting their travel needs in the most cost-effective manner, and if so, travel agents have to understand the law of conflict of interests as well as the requirements of disclosure to and informed consent by the client (¶11-180).²

Regulation of Australia's travel agencies primarily takes place through a national scheme of substantially uniform State and Territory legislation in force from 1987.³

With the twin objectives of safeguarding the travelling public against possible losses through agency collapse and ensuring the availability of a

46. *Lending of Money Act 1915* (Tas). Sec 1A (added 1995) provides that the Act does not apply to consumer credit as defined by the Consumer Credit Code: ¶14-140.

47. *Settlement Agents Act 1981* (WA); *Land Agents Act 1994* (SA).

48. *Legal Practice Act 1996* (Vic); *Legal Profession Act 1987* (NSW); *Legal Practitioners Act 1881* (Qld); *1981* (SA); *1893* (WA); *1959* (Tas); *Legal Practitioners Act 1970* (ACT); *Legal Practitioners Act 1974* (NT).

49. Corporations Law Chapter 7.

1. Provision of brochures by airlines and travel companies in itself does not amount to evidence of ostensible authority on the

part of the agent to bind the issuer as *Pr: Clayton Robard Management Ltd v Siu* (1988) 6 ACLC 57 at p 60.

2. Similarly, a real estate agent is normally the agent of the vendor, but may be commissioned as a finding agent by a buyer: ¶11-180.

3. The first Act passed was the *Travel Agents Act 1985* (WA). See also *Travel Agents Act 1986* (Vic); *Travel Agents Act 1986* (NSW); *Travel Agents Act 1986* (SA); *Travel Agents Act 1988* (Qld); *Travel Agents Act 1987* (Tas); *Agents Act 1968* (ACT); *Consumer Affairs and Fair Trading Act 1990* (NT) Pt XI. See Cordato, T, *Australia Travel and Tourism Law*, Sydney, Butterworths, 3rd ed 1999.

satisfactory level of expertise in the industry, the co-regulatory scheme requires mandatory licensing for travel agents.

Licences are issued by the Commissioner for Consumer Affairs, Travel Agents Licensing Authority (or equivalent)⁴ upon satisfactory evidence of participation in the Travel Compensation Fund (TCF — a trust fund for compensation payments). This requires paid up capital of \$10,000 for agencies with a turnover less than \$750,000, through to paid up capital of \$35,000 for a turnover exceeding \$1.5m or the taking out of indemnity insurance for notional capital purposes.

If a travel agent who is a member of the TCF fails to account to a client who has entrusted money for travel or travel related arrangements, the client may claim against the TCF for:

- direct pecuniary loss (the amount actually paid to the travel agent) resulting from agent default, and
- direct consequential pecuniary loss (financial loss additional to the money which was paid to the travel agent, excluding non-financial loss such as loss of enjoyment or disappointment), limited to 25% of the amount which was paid to the travel agent.

Statutory requirements for a licence in all jurisdictions, except the Northern Territory, include adequate premises, an agency manager of at least two years' experience in an agency who has completed approved courses, and an established track record — proved by absence of licence objections by the Commissioner for Consumer Affairs (or equivalent) or "any other person" (cf ¶8-810).

IATA. Travel agencies may apply for IATA (International Air Transport Association) accreditation, the requirements for which are similar to those for participation in the Travel Compensation Fund (above).

IATA accreditation:

- (1) provides for global appointment of travel agents by IATA Member Airlines under a form of concurrence granted by Member Airlines to the Director General of IATA;
- (2) enables an IATA accredited travel agent to participate in the centralised sales reporting and settlement facility known as the Billing and Settlement Plan (BSP) which facilitates the timely and accurate reporting of and remittance for all airline ticket sales made by travel agents on behalf of the BSP participating airlines in a given sales period; and
- (3) acknowledges the professionalism and financial health of the travel agent and imposes discipline in the sales reporting and settlement processes in accordance with the terms of the IATA Passenger Sales Agency Agreement.

4. eg in Victoria the Business Licensing Authority, established 1998.

The trust nature of funds (¶9-750) received by travel agents on behalf of their principals is upheld by case law⁵ and is established in the wording of the Passenger Sales Agency Agreement.

Despite the general efficiency and quality of the services of the travel industry, there have been problems in the industry. The collapse and insolvency of agencies, the loss of moneys paid for bookings,⁶ holidays proving to be a nightmare,⁷ the unexplained disappearance of agencies' proprietors, travellers stranded in transit, trafficking in stolen tickets, exploitation of migrant groups, undercutting of fares contrary to the Air Navigation Regulations made under the *Air Navigation Act 1920* (Cth) and abuses concerning package tours had rightly gained media attention. The Travel Compensation Fund does not cover default among source suppliers such as airlines, but the collapse of Compass Airlines was a heavy drain on the industry as members were required to refund payments made by credit card.

In addition to the State and Territory travel agents' legislation noted above, the Australian Competition and Consumer Commission (formerly the Trade Practices Commission) monitors the industry. Many disputes have been litigated under the *Trade Practices Act 1974* (Cth) — by travellers for misleading or deceptive conduct (¶7-250), or by the Commission and/or travellers for false or misleading representations (¶7-310ff).⁸

¶11-410 Real estate agents. Australian business law is mainly based on transactions in real and personal property. In the case of real property, the real estate industry plays a major role in the decision-making process regarding residential and commercial real estate. To illustrate, the activities of real estate agents include:

- representing vendors in the sale of properties, domestic as well as commercial and industrial (78% of gross fees);
- sometimes representing prospective purchasers;
- valuations where qualified valuers, otherwise "appraisals" (4% of gross fees);
- business brokerage;

5. *Stephens Travel Service International Pty Ltd (Receivers and Managers appointed) v Qantas Airways Ltd* (1988) 13 NSWLR 331.

6. *eg Aikman v Brown* (1973) 1 ACTR 121; *R v Hall* (1972) 56 Cr App R 547 (travel agent convicted of theft).

7. *eg Athens-Macdonald Travel Service Pty Ltd v Kazis* [1970] SASR 264; *Jarvis v Swans Tours Ltd* [1973] QB 233; *Jackson v Horizon Holidays Ltd* [1975] 1 WLR 1468 (noted at ¶6-460).

8. *eg Steiner v Magic Carpet Tours Pty Ltd* (1985) ATPR ¶40-581 (application dismissed). Travel agents may also be liable under sec 58(b) as in *Dawson v World Travel Headquarters Pty Ltd* (1980) ATPR ¶40-193; (1980) 53 FLR 455 (¶7-440); and especially sec 52 (misleading and deceptive conduct (¶7-250ff)); unconscionable conduct may also be involved: *Baltic Shipping Company "Mikhail Lermontov" v Dillon* (1993) (see ¶6-220).

- provision of finance;
- auctioneering where licensed (in some jurisdictions) as an auctioneer;
- assessment of property value for rental purposes;
- property management relating to dwelling houses, blocks of flats, office space, retail shops, acting on behalf of bodies corporate or strata units (18% of gross fees).

Real estate transactions involve most of the areas covered in this book, and important statutes such as the *Trade Practices Act 1974* (Cth), fair trading legislation, land law statutes, and specifically the real estate industry legislation in each jurisdiction.⁹ This industry legislation creates offences if an agent fails to comply with specific penal provisions, as well as providing for a general offence provision.

In some jurisdictions, professional standards are maintained by a “Code of Conduct”, which is given effect by regulation. A failure to comply with the Code will lead to disciplinary proceedings before the relevant statutory Board (as distinct from a prosecution).¹⁰

¶11-420 Real estate agents legislation. The real estate agents legislation in each jurisdiction is administered by a statutory Board¹¹ or a Commercial Tribunal (¶7-730) with responsibility for such matters as licensing (¶11-430), inspections, establishing educational standards and handling complaints and claims against the Guarantee Fund.

The voluntary professional associations of each State/Territory¹² and the federal body (the Real Estate Institute of Australia) provide support for members with, for example, in-service education programs and various public services.

¶11-430 Licensing of real estate agents. Licensing of real estate agents aims to protect the public against incompetence (by ensuring compliance with educational and experience qualifications) and dishonesty (by providing for standards of ethical business practice) by regulating the selling and letting of real estate. Compulsory licensing of real estate agents prevents the use of the title “agent” or “real estate agent” in the context of real estate transactions by any person except a licensed agent.¹³ Legislation in some jurisdictions

9. eg *Property, Stock and Business Agents Act 1941* (NSW); *Estate Agents Act 1980* (Vic); *Land Agents Act 1994* (SA); *Auctioneers and Agents Act 1971* (Qld); *Real Estate and Business Agents Act 1978* (WA); *Auctioneers and Estate Agents Act 1959* (Tas); *Agents Licensing Act 1996* (NT).

10. eg The Code is given effect by regulation in WA.

11. eg Department of Fair Trading (NSW); Business Licensing Authority (Vic);

Auctioneers and Agents Committee (Qld) Agents Board of the ACT.

12. eg Real Estate Institute of NSW; Real Estate Institute of Victoria; Real Estate Institute of Queensland; Real Estate Institute of SA; Real Estate Institute of WA.

13. eg *Land Agents Act 1994* (SA) sec 6; *Real Estate and Business Agents Act 1978* (WA) sec 26; *Agents Licensing Act 1996* (NT) sec 114.

prohibits, in addition to words leading to the impression that a person is a licensed agent, the words “real estate agent”, “estate agent”, “land agent”, “property agent” or “business agent” in an advertisement or public notification.¹⁴

The law establishes that a person who is not licensed as a real estate agent cannot claim commission on a property sold.¹⁵

Because real estate agents’ contractual and fiduciary duty is to obtain the best possible price for the client (the vendor), they are prohibited from purchasing from their Pr without permission any property which they have been commissioned to sell.¹⁶

In addition, in many jurisdictions real estate salespersons are required to be registered — a certificate of registration is not a licence.

The real estate agents legislation lays down the following matters aimed at good business practice for the real estate industry:

Accounting requirements. Every real estate agent and auctioneer has a fiduciary duty under real estate legislation, the law of principal and agent (§11-180, §11-200) and the law of trusts to act in the interests of, and to account to, the principal (§9-770), and agents are therefore in a comparable position to other professional agents such as solicitors, accountants and stockbrokers. Proper accounts and a trust account must be kept, and moneys deposited which are held on behalf of any person or as stakeholder. (Such moneys include deposits, and any amounts received for expenses such as advertising.) Receipts must be issued, and an annual audit is prescribed. An agent must not make withdrawals from the trust account except for expenses actually incurred, and must pay only those entitled. Advertising moneys are excluded from agents’ trust accounts in some jurisdictions.

Guarantee funds/compensation funds. Most jurisdictions establish funds built up from various sources to provide compensation to any person suffering or incurring pecuniary loss (including interest forgone and legal costs) by reason of a real estate agent’s defalcation, failure to account, and other contraventions of the law.¹⁷ Such sources include contributions or levies by licensees, interest accruing from investing the fund, fees and fines.

Offences. In seeking to uphold good business practice, the real estate agents legislation contains many prohibitions against misleading or dishonest conduct such as failure to produce a licence, failure to seek approval of a business

14. eg *Estate Agents Act 1980* (Vic) sec 38; *Agents Act 1968* (ACT) sec 103, 104, 105.

15. eg legislation such as *Real Estate and Business Agents Act 1978* (WA) sec 60(1); *Cope v Rowlands* (1836) 2 M&W 149; *Freehold Land Investments Ltd v Queensland Estates Pty Ltd* (1970) 123 CLR 418; *Tweedale v Ward* (1977) 4 QL 256.

16. eg *Estate Agents Act 1980* (Vic) sec 55; *Real Estate and Business Agents Act 1978* (WA) sec 64; *Agents Act 1968* (ACT) sec 73.

17. eg *Auctioneers and Agents Act 1971* (Qld) sec 119, including false representations by licensees.

name, furnishing incorrect information in any statement or document required by the legislation, and failure to comply with the trust account requirements. There are numerous “consumer protection” offences such as providing false information to purchasers, failure to provide the purchaser with specified written statements, overcharging on commission (competitive undercharging on recommended commissions is encouraged by the *Trade Practices Act 1974* (Cth): ¶18-660), and secret commissions (¶11-180).

¶11-440 Real estate agent’s authority. A real estate agent is usually appointed with an express agreement or authority (¶11-050). However, certain areas of authority may be implied (¶11-060), may arise by operation of law (¶11-070—¶11-080) and/or may be constituted retrospectively by ratification by Pr after the event (¶11-090). Whatever Pr can do can be delegated to Pr’s agent, and Pr can contract with a real estate agent on any terms within the law, with or without the recommended standard pre-printed real estate forms and authorities. (Contracts involving land must be in writing: ¶5-030.)

The authority of an agent has been considered at ¶11-100—¶11-130. The authority of a real estate agent usually includes the following:

- (1) *Authority to find a purchaser.* The most common form of appointment of an agent is as a negotiator to introduce purchasers to Pr. Unless clearly specified, the authority does not authorise the agent to enter a binding contract on behalf of Pr.¹⁸
- (2) *Authority to sell.* To sell, a real estate agent must have actual authority to sell given by the express agreement of Pr in writing in accordance with the requirements of sec 4 of the *Statute of Frauds* (or modern equivalent) (¶5-030). If formally authorised, an agent can sign on Pr’s behalf and bind Pr. Any special conditions above the ordinary general authority to sell — such as allowing the purchaser (TP) to enter a conditional contract (eg conditional upon the obtaining of finance: ¶5-250; ¶6-060) — should be clearly specified.
- (3) *Authority to receive deposit.* Deposits may be paid by the purchaser (TP) to A either (a) pre-contract (ie before A has contracted with the vendor, or before the purchaser has contracted with the vendor) or (b) after a contract has been entered by A with Pr:
 - (a) Deposit paid to real estate agent pre-contract. In the absence of a contract of agency or a contract of sale between A and Pr, by definition A has no authority to receive deposits for Pr. Money paid by TP to A,

18. eg *Boyd v O'Connor* [1923] VLR 603 at p 606.

as a stakeholder,¹⁹ must go into A's trust account²⁰ pending outcome of negotiations, and a court may imply a contract under which A will be liable to TP²¹ for return of money if circumstances arise which entitle TP to a return (eg failure of a condition precedent).²² Hence in the absence of authority by A, TP is unable to recover such money from Pr.²³ However, there may be evidence of an authority express (§11-110) or apparent (§11-130)²⁴ authorising A to receive deposits for Pr, thereby allowing for TP recovery from Pr.

- (b) Deposit paid to real estate agent after contract. The standard form of real estate contract of sale provides that the purchaser (the TP) shall pay a deposit, and it expressly authorises receipt of deposits by the vendor's agent to be paid into the agent's trust account upon execution of the contract by the purchaser.²⁵ Hence, where the deposit is entrusted to A as agent for Pr, A is obliged to account for it to TP. Where a contract is made which later fails, or where a conditional contract is made and the precondition fails, A holds the deposit for refund to TP. But when money is received by A as agent, and A has authority to receive it, the vendor must look to A for the payment and cannot look to the purchaser again.

(4) *Authority to receive purchase money.* Standard real estate contracts provide that purchase moneys are to be paid to the vendor or the vendor's solicitor, save that the deposit may be paid to the vendor's agent as stakeholder. Therefore in the absence of Pr's express authority, A has no authority to receive purchase money from the purchaser (TP) on behalf of the vendor (Pr) in the sense that a receipt by A is a receipt by Pr to discharge the purchaser.²⁶

(5) *Authority to manage property.* The agreement appointing a real estate agent to manage rental property will specify the agent's express functions (ie A's authority) such as to select tenants, prepare leases, collect bonds and rent,

19. ie on condition that if a contract eventuates, the money is held as deposit for Pr, but that if no contract comes about, the money is held for TP.

20. eg *Property, Stock and Business Agents Act 1941* (NSW) sec 36ff; *Auctioneers and Agents Act 1971* (Qld) sec 104; *Land Agents Act 1994* (SA) sec 13; *Auctioneers and Estate Agents Act 1959* (Tas) Pt VIA.

21. "If the estate agent receives a deposit either without other definition of its character or in terms 'as stakeholder' and the estate agent goes bankrupt or otherwise defaults, the vendor is not liable to the purchaser": *Sorrell v Finch* [1977] AC 728 at p 754, cited in *Mackay v Brice* (1979) 53 ALJR 603 at p 605.

22. See §6-060. For example, *Masters v Cameron* (1954) 91 CLR 353: §5-250. This is the position under, eg, *Sale of Land Act 1962* (Vic) Div 3 (sec 23-28).

23. eg *Sorridimi v Cave* [1964] Qd R 330 at p 335, applying *Petersen v Moloney* (1951) 84 CLR 91.

24. eg the prospective purchaser has communicated with the prospective vendor before payment of deposit to A.

25. At common law: *Wells v Birtchnell* (1893) 19 VLR 473 at p 481. By statute: see fn 20 above.

26. *Petersen v Moloney* (1951) 84 CLR 91; §11-010. See further Robinson, S, *Estate agents — agents?* (1988) 15 UQLJ 46.

re-let, inspect premises, carry out minor repairs, etc. In addition, the agent will have implied authority (§11-120) to do other things which may be incidental to these express functions.

(6) *Authority to make representations.* When a real estate agent is authorised to sell, rent, manage or otherwise deal with property, A has an implied authority over incidental matters such as describing the property and making representations regarding its character or quality. An agent has no authority (express or implied) to bind Pr contractually by promises that representations are accurate.²⁷ Over-zealousness on the part of A can lead to misrepresentation, and even though some pre-printed real estate industry contracts seek to exclude contractual effect from any representations,²⁸ an agent may personally face liability for “misleading or deceptive” conduct under sec 52 of the *Trade Practices Act 1974* (Cth) (§7-250ff), sec 53 (§7-290ff), contract law (§5-700—§5-705) and/or agency law (§11-330).

(7) *Authority to appoint sub-agents.* As noted at §11-170, because of the real estate agent’s position of discretion and trust, A has no implied authority to appoint a sub-agent.

27. *Gardiner v Grigg* (1938) 38 SR (NSW) 524 at pp 530-531.

28. Such as: “the parties to the contract acknowledge and confirm that the contract of sale embodies the whole

agreement between them”; this may constitute a false representation if the *Trade Practices Act 1974* (Cth) sec 53(g) (§7-370) (or State equivalents) is applicable.

Chapter 12

Business Names

PROTECTION OF BUSINESS NAMES ¶12-010—¶12-050

PROTECTION OF BUSINESS NAMES _____

Protection of business names under business names legislation	¶12-010
Protection of business names: the problem of overlapping jurisdictions	¶12-020
Protection of names under the tort of passing off	¶12-030
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Protection of names under the <i>Trade Practices Act 1974</i> (Cth)	¶12-050

¶12-010 Protection of business names under business names legislation. Each State or Territory has a basically uniform *Business Names Act*¹ with three main purposes:

- (1) To provide protection to the public by compelling persons who do not carry on business under their own names to register and “thus provide a means whereby their identity and whereabouts can be readily ascertained”.² “A Smith and B Jones” need not be registered if Smith and Jones are the only two partners, but if the firm consisted of Smith, Jones, and Brown, trading as Smith and Jones, the name would have to be registered. Similarly, the name “Smith and Co” would have to be registered as a business name, but the use of this name does not make Smith and Co a company because registering a business name does not

1. *Business Names Act 1962* (Vic); 1962 (NSW); 1962 (Qld); 1996 (SA); 1962 (WA); 1962 (Tas); 1963 (ACT); 1963 (NT).

2. eg *Corporate Affairs Commission v Bradley* [1973] 1 NSWLR 382 at p 389.

create a separate legal entity. (Companies are incorporated under the Corporations Law, and company names are registered under that law: ¶9-420.) This means that the owners of the business behind the name remain legally liable because the name cannot be sued.

- (2) To provide for a public registry where information concerning registered business names is available to anyone seeking it. This could be especially useful to creditors wishing to claim from the owners of a business. The registry established under the Act contains all the particulars provided with the registration application (names and addresses of the owners, nature of the business carried on, place where business carried on, etc).
- (3) To provide protection to the public from being misled or confused by the use of names which are identical with or substantially similar to existing names. The registering authority under State/Territory legislation such as the Corporate Affairs Office, the Department of Consumer Affairs or the Department of Fair Trading can reject applications for business name registration if the name is in its opinion undesirable, or if the Commission is directed under the Prohibited Names Direction or by Ministerial Direction not to register the name. The general test on undesirability applied is: "Does the name sought to be registered so closely resemble an already registered name as to be likely to deceive?" Prohibited names include those suggesting connection with government, the United Nations, banks, stock exchanges, universities, and names likely to be confused with names of companies (¶9-420) and incorporated associations. However, failure to register a business name does not in itself "operate to avoid any agreement transaction act or matter" (sec 5(5)). Once registered, a business name must be conspicuously displayed outside the place of business and on all business correspondence. The name cannot be used in soliciting loans or deposits from the public (sec 26).

Registration of a business name can protect the goodwill of a business, because it prevents someone else from registering the same or a similar name.

¶12-020 Protection of business names: the problem of overlapping jurisdictions. It is not only business names legislation which provides for protection of a name (business or otherwise). As noted in the following paragraphs, names may be protected by the tort of passing off (¶12-030), the *Trade Marks Act 1995* (¶12-040), the *Trade Practices Act* (¶12-050), the Corporations Law (¶9-420) and associations incorporation legislation (¶9-650).

Certain names may also be prohibited under other legislation such as the *Sydney 2000 Games (Indicia and Images) Protection Act 1996* (Cth) which protects licensees from unauthorised use of words and images associated with the Olympics such as "Olympics", "Paralympiad", "Sydney 2000" and

¶12-020

XXVIIth”.³ Similarly the *Olympic Insignia Protection Act 1987* (Cth) provides protection from unlicensed commercial use for a similar range of indicia and images which use words and expressions associated with the Olympics and the Paralympic Games such as “Olympic” and “Sydney 2000”.

Indeed, difficulties and clashes can arise between these registered names because it is possible to have:

- a registered trade mark used as, or as part of, a registered company, business or association name; and
- a company, business or association name used as, or as part of, a registered trade mark.⁴

By agreement between the Commonwealth, the States and the Northern Territory governments, information regarding company names and business names is consolidated on the National Names Index.⁵ Duplication of usage of names is reduced because, under the Corporations Law sec 147, 601DC, the company names (under the Corporations Law) and the business names (under State/Territory law) in the register are not available for reservation or registration by a company through ASIC.

¶12-030 Protection of names under the tort of passing off. The tort of passing off provides a remedy to protect the get up of a plaintiff’s products by preventing another person from marketing their products in a manner that states that “their goods are yours”.⁶ In addition to goods, an action in passing off may protect services, reputation, business names and goodwill.

To sue for passing off, the plaintiff must show:

- (1) reputation or goodwill;
- (2) misrepresentation — the essence of the tort of passing off is a misrepresentation to the public (whether or not intentional) liable to lead them to believe that the goods and services offered by the representor are those of the plaintiff;
- (3) damage — that the defendant’s conduct had actually resulted in, or would probably result in, imminent and substantial damage. The plaintiff would have to prove that people were or were likely to be deceived by the conduct of the defendant. If the act had been done over a substantial

3. Unauthorised use may also infringe the *Trade Practices Act 1974* (Cth) sec 52 (¶7-280), 53(c) (¶7-330) and sec 53(d) (¶7-340); ¶12-050.

4. See further Latimer, P, *Names — an examination of the interaction between names registered under legislation regulating companies, business names and associations and proposals for nationwide*

co-ordination (1987) 3 QITLJ 133; Panagiotopoulos, A, *What’s in a name? The regulation and protection of trading styles* (1995) 3 CCL 36; 75.

5. Available on the ASIC homepage at www.asic.gov.au.

6. Heydon, JD, *Economic Torts*, London, Sweet & Maxwell, 2nd ed, 1978, p 88.

period of time and not merely threatened, without damage, the onus of proof on the plaintiff would be heavy.

For passing off, the plaintiff does not have to prove intention, or intent to deceive on the part of the defendant, or that actual damage was caused or that anyone was deceived. It is enough if the defendant's practice was likely to mislead and that it involved a real risk of detriment to the plaintiff in the sense of diversion of sales, commercial reputation, etc.

The remedies for passing off include an award of damages, the equitable remedy of an account of profits, and/or an injunction.

Names are protected against passing off, as in the following examples:

— *Case examples* —

Budget Rent A Car, in the words of the High Court, had "a national reputation and had become a household name throughout Australia". Commencing business in Melbourne in 1965 under the registered business name "Budget Rent A Car System" owned by an operating company, Budget's cover by 1966 was nationwide with the exception of the Northern Territory. In 1967 Budget opened an agency in Darwin under its company name in the Northern Territory, Budget Rent A Car System Pty Ltd.

BM Auto Sales Pty Ltd ("BM") commenced a motor vehicle business in Darwin in 1965 as retailer, repairer and hirer. For its rental branch, BM's proprietor purposely chose the name Budget Rent A Car which he had seen while on a trip to Sydney. He registered this in the Northern Territory as a business name, displayed it in the window, and inserted it in the Northern Territory telephone directory. The existence of the two Budget Rent A Car operations was leading to confusion, and in 1973 Budget commenced action in passing off against BM. An injunction and damages were awarded against BM. There was evidence, as upheld by the trial judge, that BM had chosen the name as a possible future vendible commodity.

It was held by the High Court (at pp 257-258) that although "budget" is an ordinary word meaning "inexpensive", "a name composed of descriptive words may become distinctive of the business of a particular person, and if a plaintiff shows that the name in fact distinguishes his business and the use of the name by the defendant is calculated to deceive persons into supposing that the business carried on by the defendant is that of the plaintiff, and is likely to cause damage to the plaintiff's business, he will be entitled to relief." The defences of BM were rejected: (1) that Budget had no reputation in the Northern Territory to be protected (Budget was known nationally); (2) that fraud was neither sufficiently alleged nor proved (fraud confirmed to be irrelevant in passing off); and (3) that Budget's claim was barred by an unreasonable delay of six years in asserting a right, ie laches.

The court noted (at p 257) that BM "very properly did not submit that the fact that they were registered under the *Business Names Ordinance 1963* (NT) as proprietors of the name Budget Rent A Car gave them any right to use the name in such a way as to pass off their business as that of [Budget]."

*BM Auto Sales Pty Ltd v
Budget Rent A Car System Pty Ltd*⁷

7. (1977) 51 ALJR 254; (1977) 12 ALR 363.

Smith's Crisps was successfully sued by the maker of "The Kettle Chip" (a registered business name) for passing off and for breach of the *Trade Practices Act 1974* (Cth) sec 52 (¶17-280; ¶12-050) when Smith's Crisps produced its "Country Kettle" potato chips to meet loss of market share to "The Kettle Chip", a newcomer to the market. Smith's Crisps' passing off included the similar names, packet design and get-up, and the difficulty of distinguishing its chips from "The Kettle Chip".

_____ *Apand Pty Ltd v The Kettle Chip Company Pty Ltd*⁸ —

"Duff Beer". The defendant brewery was held liable for passing off and for breach of *Trade Practices Act* sec 52 (¶17-280) for marketing its beer under the name "Duff Beer". Duff Beer is the favourite of Homer Simpson of the TV series "The Simpsons", and the name "Duff Beer" was held to be an embodiment of the fictional beer in the series and to wrongly induce customers to believe that it was sanctioned or permitted by The Simpsons program.

_____ *Twentieth Century Fox Film Corporation v South Australian Brewery Co Ltd*⁹ —

Cybersquatting. D registered a variety of famous trade marks as domain names. D offered to sell its domain names to the companies that owned the corresponding trade marks. For example, D offered to sell to the owners of the trade mark Burger King the domain name burgerking.co.uk. The companies were successful in an action for passing off: the English Court of Appeal upheld the decision of the judge at first instance that the mere registration of a deceptive company name or a deceptive Internet domain name is not passing off. However, the court granted the companies an injunction to restrain threatened passing off, as registering distinctive names like "marksandspencer" made a representation to anyone checking the register that D was connected or associated with the name registered and was therefore the owner of the goodwill in the name. A person searching would not know of D. The court held that any use of the disputed names as domain names would result in passing off. Furthermore the Court of Appeal held that D had infringed the plaintiff's trade marks.

_____ *Marks & Spencer plc v One in a Million Ltd*¹⁰ —

Intangible property rights are also protected against passing off, as in the following case:

— *Case example* —

In 1973, Cadbury Schweppes started to produce Solo, a new lemon squash soft drink marketed (in the words of the court) as a "man's drink, fit for, and a favourite with, rugged masculine adventurers". In 1975, the Pub Squash Company started producing "Pub Squash" with a similar can and the same masculine marketing. With the arrival of Pub Squash and other competitors, Solo's market share fell by 15%. Solo unsuccessfully sued Pub Squash for passing off.

8. [1999] FCA 483; (1999) 88 FCR 568.

9. (1996) 66 FCR 451; (1996) ATPR ¶41-483.

10. [1998] FSR 265, discussed in Gunning, P, *Law of trade marks and domain names Part 2* (1999) 12 IPLB 5. The Final Report of the WIPO Internet Domain Name

Process of April 1999 recommending better management of Internet names and addresses is discussed by Cooper, M, *Management of internet names and address: Intellectual property issues — Final Report of the WIPO Domain Name Process* (1999) 12 IPLB 1.

The court accepted that the property protected by the tort of passing off can extend to descriptive material such as the components of an advertising campaign, and that confusion or deception may amount to passing off. However, in this case, the critical question was “were customers, or potential customers, led by the similarities in the get-up and advertising of the two products into believing that ‘Pub Squash’ was the Cadbury Schweppes product? Or, if no deception be proved, was there a real possibility of deception?”

Solo’s case failed, as the court held that Pub Squash was sufficiently distinguished from Solo and that there was no evidence of any misrepresentation, or deception or probability of deception by Pub Squash.

_____ *Cadbury Schweppes Pty Ltd v Pub Squash Co Pty Ltd*¹¹ _____

¶12-040 Protection of names under trade marks law. Certain distinctive words and pictures (devices) may be registered as trade marks under the *Trade Marks Act 1995*. See ¶3-650—¶3-680.

¶12-050 Protection of names under the *Trade Practices Act 1974* (Cth). Consumer protection provisions of the *Trade Practices Act 1974* (Cth) prohibiting misleading and deceptive conduct (sec 52: ¶7-250ff) and false representations (sec 53: ¶7-290ff) may be used to stop others using your business name. Penalties under this Act are extensive and include fines (sec 79: ¶8-780ff); injunctions (sec 80: ¶8-810); corrective advertising (sec 80A: ¶8-830) and damages (sec 82: ¶8-840).

Section 52 (and sec 53 to a lesser extent) of the Act has been used in several business v business cases involving names such as “Big Mac” (¶7-250), “Taco Bell” (¶7-250) and “Triathlon” as the name of a sports magazine.¹²

Even the use of a registered business name could amount to a breach of sec 52 and/or sec 53.¹³

A person engaged in passing off (¶12-030) would seem to be contravening sec 52. Sir Ninian Stephen noted in the *Hornsby Building Information case* that sec 52 provided “a quite extensive jurisdiction in passing off actions” and said further that this was “a consequence of the very direct relationship which necessarily exists between the deception of consumers in the course of trade and the injury caused by the unfair practices of a trade rival.”¹⁴

11. (1980) 55 ALJR 333; [1980] 2 NSWLR 851; ¶1-150.

12. *S & I Publishing Pty Ltd v Australian Surf Life Saver Pty Ltd* (1999) ATPR ¶41-667 (“Triathlon Sports” (est 1984) unsuccessful under sec 52 against “Triathlon & Multi Sport Magazine” (est 1998)).

13. *Aspar Autobarn Co-operative Society v Dovala Pty Ltd* (1987) 16 FCR 284; (1986) ATPR ¶40-727.

14. *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216 at pp 226, 230; (1978) ATPR ¶40-067 at pp 17,689, 17,691 (¶7-250); applied in passing off cases such as *The Australian Telecommunications Corporation v Hutchison Telecommunications (Australia) Ltd* (1990) ATPR ¶41-008 (Telecom failed to restrain use of name “Telecoms”); *Apand Pty Ltd v The Kettle Chip Company Pty Ltd* [1999] FCA 438; (1999) 88 FCR 568 (¶12-030).

Chapter 13

Business Finance

INTRODUCTION	¶13-010—¶13-030
FINANCING A BUSINESS	¶13-039—¶13-380
COMPANY FINANCING	¶13-390—¶13-557
BUSINESS FINANCE AND BANKRUPTCY LAW	¶13-558—¶13-740

INTRODUCTION _____

Business funding and securities: scope of this chapter .. ¶13-010

Sources of business finance

Requirement of security

¶13-010 Business funding and securities: scope of this chapter. Raising finance for a business and its activities by means of securities (to secure finance or to promise repayment) is the subject of this chapter.

An outline of financing in general (¶13-039—¶13-380) is followed by a discussion of company financing (¶13-390—¶13-550), external administration of companies under the Corporations Law (¶13-553—¶13-557) and bankruptcy law and its application to companies (¶13-558—¶13-740).

¶13-020 Sources of business finance. Business and company funding can take many forms. Funding may be obtained from a bank, financial institution or finance company, a merchant bank, or from individuals. It may be generated by extended credit terms from general trade creditors. Financial institutions provide inventory loans, for example in the form of floor plans (¶13-350) as well as factoring and accounts receivable financing. A public company can raise funding from the public by means of a share issue (¶13-430ff), a debenture issue (¶13-480) or a managed investment scheme

¶13-020

(¶13-550). There may also be special credit possibilities in some particular areas of business: farmers, for example, may obtain special loans or subsidies through the existence of special legislation relating to farm activities (¶13-300).

¶13-030 Requirement of security. Lenders will evaluate creditworthiness and the commercial risks on the basis of the ability of the business to cope with financial and other constraints. The position of the borrower will be determined by reference to such matters as income and expenditure, trading stock, debtors, plant and equipment, goodwill, freeholds, patents, licences and credit checks with credit bureaux such as Credit Reference Ltd.¹

Lenders will usually want to obtain security over the assets of the borrower. A secured loan gives the secured creditor personal rights against the borrower and enforceable rights over the property secured. In contrast, an unsecured creditor has no standing in relation to the borrower's property, and has only rights for repayment against the borrower personally. If there are insufficient funds to pay all debts, secured creditors can enforce their security to gain priority to payment over unsecured creditors. Because of the high risk involved in an unsecured loan, a lender may impose a higher interest rate.

A "security" basically refers to documentation of an obligation by a borrower to a lender that secures performance of the obligation. Some securities create proprietary or ownership interests in the property that is subject to the security, such as legal mortgages, hire-purchase, equitable mortgages and charges. Other securities depend on possession of the property by the security holder, such as pledges, pawns and liens. Assets to be secured may include real estate owned by the borrower(s). In addition lenders will often seek personal guarantees from the borrower or from associated persons (¶13-360). Collection procedures are also to be considered: Romalpa "debts" (¶13-185), judgment and execution of judgment (¶1-435), liquidation (¶9-600—¶9-626), bankruptcy (¶13-558ff), and sec 588G of the Corporations Law (¶9-460).

FINANCING A BUSINESS _____

Ways of financing a business	¶13-039
Mortgage — legal	¶13-040
Rights of mortgagee and mortgagor	¶13-045
Mortgage — equitable	¶13-047
Charge	¶13-048
Hire-purchase	¶13-050
Registration of security interests in goods	¶13-060

1. This organisation contains information on the credit history of individuals and business entities, such as details of defaults

after 60 days, judgments and bankruptcies.

Bills of sale legislation: aims	¶13-070
Operation of the bills of sale legislation	¶13-080
Definition of bill of sale	¶13-090
Subject matter of bills of sale — personal chattels ..	¶13-100
Lender's power to seize	¶13-110
Trader's bill of sale in New South Wales	¶13-120
Registration of bills of sale	¶13-130
Effect of non-registration of bill of sale	¶13-140
Security interests in Victoria and	
Western Australia	¶13-160
Seller's equitable interest by reservation of title:	
the Romalpa clause	¶13-185
Pledges — possessory securities	¶13-190
Position of the pledgor	¶13-200
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Pawn	¶13-220
Liens — introduction	¶13-230
Classification of liens	¶13-240
Possessory or common law lien	¶13-250
Creation of possessory lien by non-owner	¶13-260
Extinction of possessory lien	¶13-270
Non-possessory liens	¶13-280
Enforcement of lien	¶13-290
Farm financing — crop liens, wool liens	
and stock mortgages	¶13-300
Lending on security of choses in action	¶13-330
Assignment of choses in action	¶13-340
Floor plan financing	¶13-350
Negative pledge	¶13-355
Guarantees and suretyship	¶13-360
Rights and liabilities of guarantors	¶13-370
Discharge of guarantee	¶13-380

¶13-039 Ways of financing a business. The following table provides a summary of the different methods of financing a business discussed in ¶13-040ff.

Comparison of securities ^a				
Security	Transfer of legal interest to lender	Transfer of equitable interest to lender	Mortgagor has equity of redemption	Power to take or keep possession
Legal mortgage (general law) ¶13-040	yes	no	yes	yes
Registered second mortgage (general law)	no	mortgagor can mortgage its equity of redemption	mortgagor can mortgage its equity of redemption	no ^b
Equitable mortgage (general law) ¶13-047	no	mortgagor can mortgage its equity of redemption	mortgagor can mortgage its equity of redemption	no ^b
Registered mortgage (Torrens title) ¶13-040	legal statutory charge	no	yes	no, unless granted by court
Registered second or subsequent mortgage (Torrens title)	legal statutory charge second in priority	no	yes	subject to the rights of first in priority
Unregistered mortgage (Torrens title)	no	yes	no	no
Legal charge ¶13-048	no	no	no	no ^b
Equitable charge ¶13-048	no	yes	no	no ^b
Bill of sale ¶13-070 (not Vic and WA)	depends on agreement	no	yes	yes
Chattel mortgage (Vic and WA) ¶13-160	no	no	no	yes
Pledge ¶13-190	no	no	no	yes — has possession

continued ...

- a. Compare Everett, D and McCracken, S, *Banking and Financial Institutions Law*, LBC, 4th ed, 1997, p 433. b. Unless agreed to.

Security	Transfer of legal interest to lender	Transfer of equitable interest to lender	Mortgagor has equity of redemption	Power to take or keep possession
Pawn ¶13-220	no	no	no	yes — has possession
Possessory or common law lien ¶13-250	no	no	no	yes — has possession
Non-possessory lien ¶13-280	no	no	no	no
Statutory lien ¶13-280	no	no	no	yes

Security	Power to sell	Power to foreclose	Power to assign	Power to sue in conversion	Effect of non-registration
Legal mortgage (general law) ¶13-040	yes	yes ^e	yes	yes ^g	N/A
Registered second mortgage (general law)	yes ^c	no	yes	no	loses priority
Equitable mortgage (general law) ¶13-047	yes ^c	no	yes	no	loses priority
Registered mortgage (Torrens title) ¶13-040	can be granted by court	yes	yes	yes	loses priority
Registered second or subsequent mortgage (Torrens title)	subject to the rights of the first in priority			no	loses priority

continued ...

c. Either on application to the court, under the *Conveyancing Act 1919* (NSW) sec 109 and equivalents or under the agreement.

e. Notice the procedure for foreclosure of mortgages of Torrens title land at ¶13-045.

g. Provided that the debtor has retained its immediate right to possession.

Security	Power to sell	Power to foreclose	Power to assign	Power to sue in conversion	Effect of non-registration
Unregistered mortgage (Torrens title)	no	no	yes	no	loses priority
Legal charge ¶13-048	yes ^c	yes	yes	yes ^g	loses priority ^h
Equitable charge ¶13-048	apply to court	no ^f	yes	no	loses priority to registered legal charge
Bill of sale ¶13-070 (not Vic or WA)	yes	no	yes	yes ^g	i
Chattel mortgage (Vic and WA) ¶13-160	yes	no	yes	yes ^g	i
Pledge ¶13-190	yes	no	yes	yes	N/A
Pawn ¶13-220	yes	no	yes	yes	N/A
Possessory or common law lien (¶13-250)	no ^d	no	no	yes	N/A
Non-possessory lien ¶13-280	no ^d	no	yes	no	N/A
Statutory lien ¶13-280	yes	no	yes	no	N/A

¶13-040 Mortgage — legal. Few people can buy real estate without borrowing money. This loan is usually secured by way of mortgage on the property.

A mortgage is a transfer of property or an interest in property by a debtor to a creditor as security for payment of a debt. It is created by the

c. Either on application to the court, under the *Conveyancing Act 1919* (NSW) sec 109 and equivalents or under the agreement.

d. Unless authorised by statute: ¶13-280.

f. Subject to anomaly in mortgages over Torrens title land.

g. Provided that the debtor has retained its immediate right to possession.

h. Loses priority and may be invalid if mortgagee/chargee is a company which is wound up.

i. Failure to register means interest is invalid against bona fide purchaser for value without notice.

transfer by the debtor (the borrower — the mortgagor) of rights over the property to the creditor (the lender — the mortgagee).

The mortgage provides the mortgagee with rights against the mortgaged property itself as well as the mortgagor's promise to pay.

Torrens title mortgage. If the mortgaged property is land held under Torrens title (§13-300), the mortgage is registered on the certificate of title. This gives the mortgagee a claim called a "statutory charge" over the land (§13-048) for the right to repayment.

The rights of a mortgagee of Torrens title land are qualified. For example, the mortgage is limited to a specific period and, upon repayment of the debt and formal discharge of the mortgage, clear title reverts to the mortgagor. The mortgagor remains the legal or registered owner of the property, with an equity of redemption,² subject to the statutory charge of the mortgagee. An unregistered Torrens title mortgage creates only an equitable interest (§13-047).

Old system or general law mortgage. In contrast, a general law (§13-370) mortgage, created by the execution of a deed, transfers ownership of the property (legal title) and the right to possession to the mortgagee. The mortgagor gives the title deeds to the mortgagee, who holds them as security for the loan. Normally there is a contractual provision that if the necessary payments are made, the mortgagee will not take possession. The mortgagor retains its equity of redemption (§13-045). If the mortgagor creates another mortgage, it will be an equitable mortgage (§13-047) because the first mortgagee has legal title to the property mortgage.

§13-045 Rights of mortgagee and mortgagor. General property legislation and the mortgage document itself set out the rights and duties of mortgagee and mortgagor.

Mortgagee. Under Torrens title legislation and the general law, the mortgagee has many rights and powers even if the mortgagor is not in default. These include the:

- power to insure;
- right to bring legal action against third parties;
- power to assign or transfer the mortgagee's own interest;
- right to possession (general law only);
- power to create and to enforce a lease.

The mortgagee's rights and powers if the mortgagor defaults include the:³

2. As the Torrens title mortgagor remains the legal owner, "equity of redemption" is used to refer to the mortgagor's right to redeem: §13-045.

3. eg *Conveyancing Act 1919* (NSW) sec 109; *Property Law Act 1958* (Vic) sec 101;

Law of Property Act 1936 (SA) sec 47; *Property Law Act 1969* (WA) sec 57; *Conveyancing and Law of Property Act 1884* (Tas) sec 21.

- right to possession;
- power of sale;
- power to foreclose;
- power to appoint a receiver;
- right to enforce the mortgagor's contractual obligation to pay and the other covenants in the mortgage.

Mortgagor. Mortgage documentation is mainly concerned with protecting the security of the mortgagee by imposing obligations on the mortgagor. These include the obligation to repay the principal and interest as specified, various “positive covenants” (such as to maintain the property and to pay rates, taxes and outgoings) and various “negative covenants” (such as not to allow the property to deteriorate, not to allow nuisance and not to part with possession).

Mortgagor's equity of redemption. The mortgagor has the right to reclaim the property on payment of the mortgage debt (and costs). This is the mortgagor's equity of redemption. The equity of redemption is protected by the rules of equity which prohibit any agreement — any limitation, fetter or “clog on the equity of redemption” — to prevent the mortgagor from redeeming on payment of what is due. Examples of “clogs” include:

- provisions attempting to extinguish the right to redeem — such as an option for the mortgagee to purchase the property;
- the imposing of unreasonable conditions and exclusion clauses in mortgages;
- time and other limitations on the right to redeem;
- requiring the payment of moneys other than principal, interest and other recoverable costs.⁴

Remedies available to a mortgagee. If the mortgageor defaults, there are a number of remedies available to the mortgagee:

- (1) Sue for breach of contract for compensation for payments owing. This can include any shortfall after the sale of the property.
- (2) Enter into possession by actual physical entry or by legal proceedings to evict the mortgagor.
- (3) Appoint a receiver to run the property if it is a business and/or to hold property in the hope that its market value will improve. The receiver must act in good faith.⁵ The receiver is the agent of the mortgagor.
- (4) Apply to the court for foreclosure. This removes the mortgagor's equity of redemption, and ownership passes to the mortgagee.

4. Disputes on “clogs” are now often litigated through unconscionability legislation (§5-755—§5-760), restraint of trade at common law (§5-840—§5-887), the *Trade Practices Act 1974* (Cth)

(§8-050), and the unconscionability provisions of the consumer credit legislation (§14-240).

5. eg *Conveyancing Act 1919* (NSW) sec 109 and equivalents, set out in fn 3.

- (a) In the case of Torrens title land, the mortgagee must give notice to the mortgagor. The mortgagor must not have paid for six months. The property must then be offered for sale by auction. If bids prove too low to pay off the mortgage, and other assets of the mortgagor are insufficient to pay off the mortgage, the mortgagee can then apply for foreclosure, and the property becomes the mortgagee's.
 - (b) In the case of land under general law or old system title, the mortgagee can apply to the court to remove the mortgagor's equity of redemption. If the mortgagor cannot discharge the debt within six months, the mortgagee becomes the absolute owner in equity as well as in law.
- (5) Exercise its power of sale. If the mortgagor defaults, the mortgagee may enforce its security by selling the mortgaged property. When it exercises its power of sale, the mortgagee must give the notice required by statute, act in good faith and take reasonable care to obtain the true market value. On the application of the mortgagor, the mortgagee may be ordered to exercise its power of sale, for example to stop interest accruing.⁶

— *Case examples* —

The mortgagee in possession exercised its power of sale and sold the mortgaged property at auction for £44,000. Advertisements for the auction prepared by the mortgagee's real estate agents advised planning permission for 35 houses, but did not mention the alternative planning permission for 100 flats. The mortgagor drew this to the attention of the mortgagee, but the advertising was not corrected and the sale went ahead. Evidence of valuers put the value of the property if sold for flats as at least £65,000. The court confirmed that "a mortgagee in exercising [its] power of sale does owe a duty to take reasonable precautions to obtain the true market value of the mortgaged property at the date on which [it] decides to sell it." The mortgagor was entitled to damages to be determined according to the value of the mortgaged property.

— *Cuckmere Brick Co Ltd v Mutual Finance Ltd* —

The power of sale is for the benefit of the mortgagee. The mortgagee in exercising its power of sale is not a trustee of the power of sale, and the mortgagee can purchase the mortgaged property if it can show that the sale is in good faith and at the best price reasonably obtainable at the time. If the mortgagee cannot show this, the sale may be set aside. Damages representing the difference between the sale price and the market price were awarded to the mortgagor when the spouse of the mortgagee bought the mortgaged property below market price on behalf of a family company.

6. eg *Palk v Mortgage Services Funding Plc* [1993] 2 WLR 415, noted (1994) 68 ALJ 65.

7. [1971] 1 Ch 949; applied, eg, *Nathan Securities Ltd v Stavfield Holdings (No 29)* (1993) 6 BCB 227, noted (1994) 68 ALJ 836.

Inadequate marketing of the property accounted for its not realising its best price and for the mortgagee's bid being the only bid at the auction.

_____ *Tse Kwong Lam v Wong Chit Sen*⁸ _____

The mortgagee in possession advertised the mortgaged land as "Unattractive, subject to flooding, filthy" and accepted an offer of \$8,000. Evidence showed that the fair market price was \$14,000-\$15,000 and the mortgagor, who had remained camped on the land, gained a court order to restrain the mortgagee bank from completing the contract at \$8,000. The court confirmed that "mere errors of judgment do not constitute a breach ... a failure otherwise to take reasonably adequate steps to ensure a sale at a fair price will constitute a breach of that duty."

_____ *National Commercial Banking Corporation of Australia Ltd v Solanowski*⁹ _____

The mortgagee inadequately advertised its proposed mortgagee auction, and the property was passed in at \$20,000. It was later sold for \$55,000. As there was evidence before the trial judge that the value was no less than \$80,000, damages of \$25,000 were awarded to the mortgagor for the mortgagee's breach of duty under the Queensland Act. This case confirms that the mortgagee exercising its power of sale does not discharge its duty to the mortgagor by employing an agent. The mortgagee is responsible (vicariously liable: ¶14-270) for the actions of its real estate agent such as default, negligence and omissions. Therefore the mortgagee is vicariously liable for the omission of its agent to adequately advertise a proposed mortgagee auction.

_____ *Commercial and General Acceptance Ltd v Nixon*¹⁰ _____

Proposed action by a mortgagee to enforce its security under a mortgage may be met with various defences by the mortgagor including:

- (a) misleading or deceptive conduct: *Trade Practices Act 1974* (Cth) sec 52 and *State/Territory Fair Trading Act* equivalents (¶17-250ff). For example, there may be evidence that the mortgagee's conduct was misleading or deceptive and/or that it had given negligent advice in respect of the financing of its operations and the management of those finances.
- (b) unconscionability under the *Trade Practices Act 1974* (Cth) (¶15-755—¶15-756), *State/Territory Fair Trading Act* equivalents (¶15-760), the *Contracts Review Act 1980* (NSW) (eg *West's case*: ¶15-760) and at common law (¶15-730).

8. [1983] 1 WLR 1349.

9. (1984) NSW ConvR ¶55-194.

10. (1981) 152 CLR 491, dismissing an appeal from [1980] Qd R 153. Damages were awarded for breach of *Property Law Act 1974* (Qld) sec 85 which requires the mortgagee to "take reasonable care to

ensure that the property is sold at the market value"; also applied, eg, *Muirhead v Commonwealth Bank of Australia* (1996) 125 FLR 434; to similar effect, eg, *Transfer of Land Act 1958* (Vic) sec 77; Robinson, S, *Lenders' (and receivers') liability when selling: the need to resort to basic principles* (1994) 68 ALJ 206.

- (c) procedures in the Consumer Credit Code, which regulates mortgages over property securing the obligations of a debtor or a guarantor (§14-150).

¶13-047 Mortgage — equitable. An equitable mortgage is inferior to a legal mortgage. An equitable mortgagee will generally rank second after a legal mortgagee when mortgagees compete for the same land or goods (§3-270). An equitable mortgage means:

(1) a mortgage of a *legal* interest in property which does not comply with the legal formalities for the creation of a legal mortgage. Examples include:

- an express or implied agreement to give a legal mortgage over a legal interest without in fact signing a legal mortgage (as in *Heid's case*: §3-270).
- a mortgage by deposit: handing over documents of title (Torrens title or general law) to the lender until repayment of the debt.
- an unregistrable transaction.
- an unregistered instrument in statutory form (Torrens title land only);

(2) a mortgage of an *equitable* interest in property (§3-210ff). Examples include:

- an agreement to secure property or goods to be acquired in the future (future property: see, for example, §13-100).
- a beneficiary's interest under a will (§3-700);
- a beneficiary's interest in a trust (§9-760);
- the mortgagor's equity of redemption remaining after the mortgagor has signed a legal mortgage (§13-045).

Property law legislation in all jurisdictions requires an equitable mortgage to be in writing (disposition of an equitable interest: §9-840) or in the form of an equitable assignment (§13-340).

Equitable mortgages over motor vehicles in the jurisdictions with title security systems come within the definition of a "security interest" and are regulated by that legislation: §14-320—§14-380.

Rights of equitable mortgagee. If the mortgagor defaults, the equitable mortgagee has various rights such as applying to the court for an order of specific performance, foreclosure, judicial sale and/or the appointment of a receiver. The equitable mortgagee may have been able to reserve specific powers equivalent to those of a legal mortgagee, and may therefore be able to sue on the mortgagor's contractual obligation to pay and the other covenants in the mortgage. If the equitable mortgage is over company property, the mortgagor should register a floating charge: §13-048.

¶13-048 Charge. A charge is a security for the payment of a debt or a commitment for the performance of an obligation.¹¹ Under the charge, the creditor or lender (the chargee) acquires certain rights against the debtor or borrower (the chargor) such as the right to payment out of a specific fund or the right to payment from the proceeds of the sale of property. The fund or property is then “charged” with the debt to be paid out of it.

The chargor does not lose ownership of the property charged, and the chargee has neither possession of nor legal title to the property charged.

Charges can be classified as (1) legal or equitable, and (2) fixed or floating:

(1) Charges: legal or equitable.

A *legal charge* includes:¹²

- a mortgage of land under Torrens title (¶13-040).
- a “statutory charge” — in contrast to a charge created by private agreement. A “statutory charge” refers to a charge created by legislation.

— *Examples of statutory charges* —

Some legislation imposes a statutory charge in favour of creditors. For example, governments and local councils have a statutory charge over land for unpaid rates and taxes.

If a person has received money or property of a bankrupt under a transaction which is void against the trustee in bankruptcy (¶13-670—¶13-700), the Official Receiver has a statutory charge over that property under the *Bankruptcy Act 1966* (Cth) sec 139ZR (¶13-630).

When a debtor’s property comes under Part X of the *Bankruptcy Act 1966* (Cth), it is subject to a statutory charge: ¶13-570.

Third parties have a statutory charge over insurance moneys paid by the insurer to the insured under a third party liability insurance policy.¹³

A mortgage of a ship is a statutory charge.¹⁴

The statutory lien over sugar cane is a statutory charge (¶13-300).

An *equitable charge* imposes a burden on the property. It arises under an agreement enforceable in equity and does not involve a change of ownership.¹⁵ An equitable charge remains a security interest, whereas an

11. Compare the two meanings of a “charge” in the criminal law: an accusation by the prosecution (¶2-110), and a judge’s address or direction to the jury (¶2-120); ¶13-540n.

12. A rent charge on land created by grant is another example of a legal or common law charge.

13. eg *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) sec 6, applied in *Bailey*

v New South Wales Medical Defence Union Ltd (1995) 69 ALJR 890.

14. *Shipping Registration Act 1981* (Cth).

15. Like an equitable mortgage: ¶13-047. “Equitable charge”, “equitable lien”, “charging order”, “equitable interference” and “equitable assignment” are sometimes used interchangeably: ¶13-280n.

equitable mortgage potentially transfers equitable title to the equitable mortgagee if the mortgagee forecloses. An equitable charge includes:

- a floating charge;
- a charge over company property (Corporations Law sec 9). This must be registered under Corporations Law sec 262: see further ¶13-540.

— *Examples: equitable charges* —

Example 1. Testator may leave property to X subject to payment of \$2,000 to Y. Y has an equitable charge over the property for \$2,000. The owner of the property retains the legal title to the property subject to the interest of Y.

Example 2. In consideration of a loan, the owner of property retains legal and equitable title to the property, but confers on the lender certain rights which are exercisable on default. The rights of the lender are automatically cancelled when the borrower repays the loan.

Example 3. A solicitor who obtains an order for costs on behalf of a client has an equitable charge or an equitable lien over funds of the client held for costs.¹⁶

A lender with an equitable charge over land is entitled to the surplus after repayment to a mortgagee exercising its power of sale: on sale of the land, the equitable charge is converted to a charge over the proceeds.

Equitable charges in Victoria and Western Australia come within the definition of “security interest” in the *Chattel Securities Act 1987* (Vic) and the *Chattel Securities Act 1987* (WA) and as such are regulated by those Acts (¶13-160). If a security interest is over a motor vehicle, an equitable charge should be registered (¶14-320—¶14-380).

(2) A charge may be a fixed charge or a floating charge or a combination of both.

A *fixed (or specific) charge* relates to and attaches to specifically identifiable property such as plant or equipment. It can apply to property not yet owned by the chargor, or property not yet in existence (future property).

A fixed charge can be in the form of a legal mortgage or an equitable mortgage or an equitable charge.

A *floating charge* does not attach to any particular assets of the chargor, but floats over assets or property which may be constantly changing, such as trading stock.¹⁷ A floating charge is an equitable charge. On default, the floating charge “crystallises” or is converted to a fixed charge over assets of the chargor (¶13-480).

16. *Akki Pty Ltd v Martin Hall Pty Ltd* (1994) 35 NSWLR 470; ¶13-280.

17. Classic definitions appear in *Illingworth v Houldsworth* [1904] AC 355 at p 358,

and *United Builders Pty Ltd v Mutual Acceptance Ltd* (1980) 144 CLR 673, per Stephen J at pp 681-682.

A floating charge has the following features:¹⁸

- It includes all the property of a company, including trading stock, debtors and other property employed in day to day business. (Fixed assets such as office premises may be concurrently subject to a specific or fixed security.)
- It covers present and future assets, and some of the assets are likely to change in the ordinary course of business.
- Until one of a number of possible events has occurred when the charge “crystallises”, the company has virtually complete freedom to deal with the assets covered by the floating charge (within the limits of the document creating the charge).

A floating charge therefore gives flexibility to the borrower. In contrast, a borrower subject to a mortgage may have to obtain the lender’s approval to trade in a particular item of equipment under a specific chattel mortgage or goods mortgage (¶14-140).

Crystallisation of the floating charge. When something occurs to breach the terms upon which the charge is given, the charge “crystallises” or is converted to a fixed charge, producing a revocation of the “licence” which the company had from the chargeholder to deal with the assets subject to the floating charge in the ordinary course of business. For example, the floating charge crystallises where the parties have expressly provided for crystallisation:

- (1) on the happening of a specified event (such as default by the chargor in payment or the chargor allowing the value of the charged assets to fall below a minimum amount);
- (2) on the appointment of a receiver (¶13-553);
- (3) if the chargor breaches a restriction on future borrowings (a negative pledge: ¶13-355).

If the parties have not expressly provided for crystallisation, the floating charge will crystallise automatically if the chargee can appoint a receiver or go into possession on default by the chargor. Automatic crystallisation can present difficulties, as neither party may be aware of the crystallisation, and both chargor and chargee may continue as if the charge is still floating — including disposing of assets to third parties. If insolvency results, there may be insufficient property to meet all liabilities.

Priorities between floating charges and later fixed charges. If a chargor grants a floating charge and later grants another charge over the same property, the priorities are in line with the general law (¶3-270):

- Where there are equal securities, the first in time will prevail.
- A legal charge takes priority over an earlier equitable charge.

18. Based on ALRC, *General Insolvency Inquiry* Report, para 179 (1988).

- A later fixed charge takes priority over an earlier floating charge.
- Where there are two securities — one registered and one unregistered — the registered security will take priority over the unregistered security (§13-540).

§13-050 Hire-purchase. Hire-purchase agreements are contracts of hire which give the hirer an option to buy. They are discussed further at §14-060—§14-065.

Certain hire-purchase agreements entered into by natural persons or strata corporations for non-business reasons are regulated by the Consumer Credit Code (sec 10: §14-140).

Hire-purchase provides another method for the purchase of goods when the buyer cannot or does not wish to pay cash. Under a hire-purchase agreement the “hirer” has possession and use of the goods until payment is made in full. Ownership remains with the “owner” (such as the financier). The hirer has an option to buy and an option to return the goods, but is under no obligation to buy.

Strictly speaking, hire-purchase is not a “security” because a security can only be acquired in property belonging to another person. Like a Romalpa clause (§13-185) and a lay-by, hire-purchase is an example of the lender retaining ownership or reserving title. Because ownership of the goods is not transferred to the hirer during the course of the hire-purchase, the hirer cannot transfer ownership to a third party — under the *nemo dat* rule (§3-270) — without the owner’s authority. Hence this inability of the hirer to dispose of the goods results in hire-purchase agreements achieving the same effect as traditional security arrangements. Title reserved in the goods by the owner achieves the same purpose as other security interests since the owner of the goods sold on hire-purchase holds something more tangible than just a promise to repay.

Because the hirer is not the owners, potential lenders must remember that possession of goods is not necessarily ownership. A lender must be careful in taking goods as security, because if goods are hired, the hirer will probably be in breach of the hire-purchase agreement.

A lender who has taken hired goods or leased goods as security for a loan will lose out against the true owner of the goods under the rule that no one can give what he does not have. (This is the *nemo dat* rule, mentioned above (see also §3-270).) The lender may get some protection if it has obtained a warranty from the person in possession of the goods that the person in possession does in fact have the power to convey title in the goods to the lender (cf §7-040). This does not protect the lender against the true owner of the goods, but it does give some remedy against the borrower.

§13-060 Registration of security interests in goods. A borrower can give a mortgage over personal property (such as a car) to a

§13-060

lender as security for finance. The law regulating these goods mortgages varies from jurisdiction to jurisdiction as follows:

- In all jurisdictions except Victoria and (substantially) Western Australia, the Bills of Sale legislation requires registration of goods mortgages: ¶13-070. In Victoria and Western Australia, the equivalent is the chattel securities legislation: ¶13-160.
- Legislation in all jurisdictions requires registration of security interests over motor vehicles on the Vehicles Securities Register, REVs or equivalent: ¶13-160; ¶14-340.

¶13-070 Bills of sale legislation: aims. A bill of sale is a mortgage of goods (or a chattel mortgage) given as security for a loan by the owner (the borrower, grantor or mortgagor) to the lender (the grantee or mortgagee). For example, a bill of sale may be used to finance a car or shop fittings.

Ownership (property) passes under some bills of sale, but possession remains with the grantor.

The bills of sale legislation of the various jurisdictions (except Victoria and substantially Western Australia: ¶13-060) aims:¹⁹

- to ensure that there is an efficient and effective way of allowing for loans to be made on personal chattels.
- to require registration of such loans. Registration acts as a warning to the rest of the world that property remaining in the possession of the debtor has been mortgaged. This prevents a debtor from giving a fictitious appearance of prosperity to potentially defraud third parties.
- to provide legal protection to borrowers and lenders. Documents which do not comply with the statutory form are invalid.
- to prevent borrowers from placing assets beyond the reach of general unsecured creditors, such as trade suppliers or judgment creditors, and includes provisions attacking transactions which are designed to give preferences to particular creditors.

If a bill of sale secures consumer credit, the credit is regulated by the Consumer Credit Code (¶14-140ff).²⁰

What used to be a bill of sale in Victoria and substantially Western Australia is now regulated as a chattel mortgage in those jurisdictions: ¶13-160.

¶13-080 Operation of the bills of sale legislation. The bills of sale legislation applies if:

19. The relevant legislation in each of the jurisdictions is as follows. NSW: *Bills of Sale Act 1898*; Vic: *Chattel Securities Act 1987*; Qld: *Bills of Sale and Other Instruments Act 1955*; SA: *Bills of Sale Act*

1886; WA: *Bills of Sale Act 1899*; Tas: *Bills of Sale Act 1900*; ACT: *Instruments Act 1933*; NT: *Instruments Act 1935*.

20. eg *Bills of Sale Act 1900* (Tas) sec 4A.

- (1) The documentation of the security comes within the definition of a "bill of sale" (§13-090).
- (2) The security for the loan is personal goods (§13-100).
- (3) The lender has the power to seize the property if the borrower defaults (§13-110).

When a bill of sale is made, it must be documented and recorded in the office of the relevant regulator. (In New South Wales, for example, this is the General Register of Deeds.)

§13-090 Definition of bill of sale. The bills of sale legislation applies to many security agreements including an assignment, a transfer of goods and a declaration of trust without transfer. It also applies to any power or authority to take possession of goods as security for a debt.

The definition of "bill of sale" in the New South Wales legislation is as follows:²¹

"**'Bill of sale'** shall include bills of sale, assignments, transfers, declarations of trusts without transfer, and other assurances of personal chattels, and also powers of attorney, authorities, or licences to take possession of personal chattels as security for any debt and also any agreement, whether or not intended to be followed by the execution of any other instrument, by which in equity any charge or security is conferred over personal chattels to be acquired after the date of the agreement, but shall not include the following documents, that is to say: Deeds of assignment under Part XI and deeds of arrangement under Part XII of the (Commonwealth) Bankruptcy Act 1924-1933; marriage settlements; transfers or assignments of any ship or vessel, or any share thereof; transfers of goods in the ordinary course of business of any trade or calling; bills of sale of goods in foreign parts or at sea; bills of lading; India warrants; warehouse-keeper's certificates, warrants, or orders for the delivery of goods; or any other documents used in the ordinary course of business as proof of the possession or control of goods, or authorising, or purporting to authorise, either by indorsement or by delivery, the possessor of such document to transfer or receive goods thereby represented."

A bill of sale may be *conditional* or *absolute*:

- (1) *A conditional bill of sale* is a security. It is a mortgage, where ownership (not possession) of the goods is transferred to the grantee on the condition that ownership of the goods is to return to the borrower upon repayment of the principal and interest. The transfer becomes void on repayment of principal and interest.
- (2) *An absolute bill of sale* is a sale, gift or settlement where ownership (not possession) of the goods is transferred to the grantee absolutely with a contractual proviso for reconveyance.

The courts will determine whether a document is a bill of sale not by its form but by its substance.²² If a document proves to be a bill of sale, and

21. Sec 3 of the NSW legislation. The definitions in the other States are Vic sec 32; Qld sec 6(1); SA sec 2; WA sec 5; Tas sec 4; ACT sec 8; NT sec 8.

22. *Young v Mook Ah Meng* (1891) 17 VLR 140.

fails to comply with the legislative formalities, it may be ineffective, as illustrated by the following cases.

— *Case examples* —

In consideration of a loan of £225 from his wife, Schofield transferred his car to her and acknowledged the transfer on the back of the registration certificate. Registration was transferred to the wife, and she paid the annual registration fee and insurance thereafter. When the car was seized by the bailiff under a writ of execution against Schofield, the transfer was pleaded by way of defence. However, it was determined that the transfer was in fact a bill of sale; and because it had not been registered as required by the legislation, it was found to be void as against the bailiff. The bailiff was therefore held to be entitled to the car.

— *Robert Nettlefold Pty Ltd v Schofield*²³ —

A floor plan or display agreement between a finance company and a motor car dealer has been held not to be a bill of sale within the statutory definition. The agreement in question was to provide the dealer with the finance necessary to enable him to carry on his business of buying and selling motor vehicles. Pending sale of the vehicles, they would be on display in the dealer's showroom, although the agreement provided that until sale the property in the vehicles vested and remained in the finance company and that the dealer sold them as agent for the finance company — in the meantime, he held the vehicles as bailee. In this case, the Privy Council commented upon the fact that although the dealer's possession of the vehicles was solely attributable to its arrangement with the finance company, "such arrangements where there is no delivery [ie to the owner of the goods, in this case, the finance company] are not without some jeopardy owing to the Bills of Sale Acts". (Floor plan financing is discussed at ¶13-350.)

— *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd*²⁴ —

¶13-100 Subject matter of bills of sale — personal chattels. Bills of sale can only be granted over "personal chattels" such as boats, cars and computers. For example, the definition of "personal chattels" in sec 3 of the New South Wales legislation is as follows:²⁵

"'Personal chattels' shall mean goods, furniture, fixtures, and other articles capable of complete transfer by delivery (either at the time of the making or giving of a bill of sale of the personal chattels comprised in or made subject to the bill of sale or at any time thereafter); and shall not include chattel interests in real estate, nor shares or interests in the stock, funds, or securities of any Government, or in the capital or property of any incorporated or joint stock company, nor choses in action, nor any stock or produce upon any farm or lands which by virtue of any covenant or agreement, or of the custom of the country, ought not to be removed from any farm where the same are at the time of making or giving of such bill of sale."

23. (1934) 29 Tas LR 93.

24. (1965) 112 CLR 192 at p 205 (¶7-020).

25. For comparable definitions from other jurisdictions see ¶13-090n.

This statutory definition of personal chattels is wide and includes both fixtures (§13-080) and crops (when harvested; crops prior to harvest are covered by crop mortgage legislation (§13-300)).

A bill of sale cannot be granted over:

- non-physical property (a chose in action (§13-040)), or
- future (or potential) property.²⁶

§13-110 Lender's power to seize. The power to seize or to take possession of the goods covered by a bill of sale is set out in the legislation.²⁷ This makes a bill of sale different from a letting of goods with no power to seize.

— *Case example* —

P appointed D its customs agent under an oral agreement to bring into Australia goods purchased overseas by P. The oral agreement provided that each contract entered into by D should give D a particular lien and a general lien over the goods for any amounts owing by P to D (§13-250). The agreement was analysed as a pledge (§13-190) which did not require registration as a bill of sale because D did not have the power to seize the goods.

— *Re Vital Learning Aids Pty Ltd and the Companies Act*²⁸ —

Events giving rise to the power to seize include default in payment, bankruptcy of the grantor and fraudulent removal of the goods by the grantor.

Taking possession under a bill of sale which is a consumer mortgage is regulated by the Consumer Credit Code: §14-260.

§13-120 Trader's bill of sale in New South Wales. In New South Wales there is a unique type of security, operating only in relation to traders, known as the trader's bill of sale. This bill must be lodged for registration within 15 days of execution. It has no validity at law or in equity without registration.

"Trader" is defined in the legislation (sec 3) to mean "a person engaged or about to engage in the business of selling by retail any goods, wares or merchandise". Farmers, companies and licensees under liquor licensing legislation are excluded from this definition. A "trader's bill of sale", as defined in sec 3 of the New South Wales Act, means a bill of sale given by a trader over personal chattels including plant, fixtures, fittings and stock in trade "owned and used or intended to be used, or which are to be thereafter acquired."

26. *Akron Tyre Co Pty Ltd v Kittson & Ors* (1951) 82 CLR 477. Future property can be assigned in equity: see, eg, *Holroyd v Marshall* (1862) 10 HL Cas 191; 11 ER 999; see also §13-047 on equitable

mortgages, and §13-340 on assignment of choses in action.

27. eg NSW sec 4(1), 5C; Qld sec 6(2); ACT sec 9(1).

28. [1979] 2 NSWLR 442.

A trader's bill of sale differs from an ordinary bill in the following regards:

- *Dates.* A trader's bill must be lodged for registration in the General Register of Deeds within 15 days of its making (sec 5C(2)(b)) (ordinary bills: 30 days (sec 4)) and it will be registered after the expiration of 14 days unless a caveat is lodged by a creditor (sec 5F).
- *Caveats.* Persons objecting to registration can lodge a caveat within 14 days of the lodging of the bill (sec 5G). The grantor or grantee may summon the caveator to appear in the metropolitan district of the District Court; if the judge determines that the caveator is an unsecured creditor of the grantor, the judge may prohibit registration of the bill until satisfaction of the caveator's debt (sec 5G-5I). Compare these caveats with caveats under real property law: ¶3-280.
- *Prescribed particulars.* Details must be provided of the chattels comprised in the trader's bill of sale (no such details are required for an ordinary bill of sale) (sec 5C(2)).
- *Statutory declaration.* The trader must furnish a statutory declaration that he is a trader and that the bill of sale is a trader's bill of sale; without this, the bill cannot be registered as a trader's bill of sale, and if registered as an ordinary bill of sale, will be ineffective in regard to any "trade goods" covered by it (sec 5B).
- *Non-registration.* An unregistered trader's bill of sale is invalid between grantor and grantee; an unregistered ordinary bill of sale remains valid between grantor and grantee and is only void as regards certain other persons: ¶13-140.

¶13-130 Registration of bills of sale. For maximum effectiveness, bills of sale must be registered within the time specified in the legislation.²⁹ Non-registration can mean invalidity as against certain classes of creditors (see ¶13-140) (although it appears that this is not the case in Western Australia), and the register is a public record of goods, stock, etc which are subject to bills of sale. While an oral mortgage of goods might avoid the requirements of bills of sale legislation, it would probably not avoid creditors in bankruptcy proceedings (¶13-558ff).

The documents to which the legislation applies and which therefore are affected by the registration requirements are those on which the title or ownership of the transferee of the goods depends.

29. In NSW (ordinary bill of sale), SA and the ACT, within 30 days of execution; in NSW for a trader's bill of sale, within 15 days of being made; in WA, within a period between 10 and 60 days of

execution, depending on the distance of the place of execution from Perth; in Tas, within 21 days of date of execution. No time is set for registration of bills of sale in Queensland and the Northern Territory.

¶13-140 Effect of non-registration of bill of sale. Failure to register a bill of sale leads to different consequences in different jurisdictions:

(a) *New South Wales (trader's bill of sale), Tasmania, Northern Territory.* An unregistered bill of sale is void both between the parties themselves and as against creditors. The debt may still be sued for, but the property cannot be seized upon default.

(b) *New South Wales (ordinary bill of sale), South Australia, Western Australia, the ACT.* The debt giving rise to the unregistered bill of sale can still be sued on, but an unregistered bill of sale is void against:³⁰

- the official receiver or trustee in bankruptcy of the grantor (¶13-558ff);
- the assignee or trustee of an assignment by the grantor for the benefit of the grantor's creditors;
- a sheriff or bailiff seizing the goods of the mortgagor in the course of execution of a judgment (¶1-435); and
- a judgment creditor on whose behalf such execution has been issued (¶1-435).

(c) *Queensland.* An unregistered bill of sale is valid between the parties but is void as against third persons, such as the creditors, the grantor's trustee in bankruptcy and an innocent third party.³¹

Chattel securities/vehicles securities legislation. Amendments to the bills of sale and the chattel securities/vehicles securities legislation have consolidated the two registration regimes (¶14-340) so that registration under one removes the need for registration under the other. For example, the registration of an interest of the grantee of a bill of sale under the *Registration of Interests in Goods Act 1986* (NSW) is deemed to satisfy the registration requirements under the *Bills of Sale Act*.³² The registration provisions in the *Queensland Bills of Sale and Other Instruments Act 1955* no longer apply to an instrument relating to a motor vehicle.³³

¶13-160 Security interests in Victoria and Western Australia. Security interests in goods in Victoria and in Western Australia are regulated by the *Chattel Securities Act 1987* (Vic) and the *Chattel Securities Act 1987* (WA) respectively, which have replaced bills of sale legislation in Victoria and have largely replaced it in Western Australia.³⁴

30. eg NSW sec 4(2); WA sec 25.

31. Qld sec 7: eg *Ex parte Dalgety Farmers Limited* [1987] 2 Qd R 481.

32. *Bills of Sale Act 1898* (NSW) sec 3A.

33. Sec 11A, added by the *Motor Vehicles Securities Act 1986* (Qld).

34. The *Bills of Sale Amendment Act 1987* (WA) provides for registration of bills of sale only over goods covered by the amended definition of "chattels" in the *Bills of Sale Act 1899* (WA) sec 5 — "stock and wool or growing crops where separately charged or bailed".

The chattel securities legislation aims to ensure that a person who buys goods that are subject to a "security interest" (sec 3), innocently and without notice, obtains clear title to the goods.

In the case of a motor vehicle, a person is deemed to have notice of a security interest if the interest was registered on the Vehicles Securities Register established under Part 3 (Vic)/Part III (WA) ("Registrable Goods") of the legislation (¶14-340).

Security interest. The chattel securities legislation concerns a "security interest", defined in sec 3 as "an interest in or a power over goods ... which secures payment of a debt or other pecuniary obligation ... but does not include a possessory lien or pledge." This is discussed at ¶14-340. "Goods" over which there is a security interest are defined to include all personal chattels and fixtures (with some exceptions such as money and choses in action: ¶3-040). Motor vehicles are the main class of goods which are registrable (sec 13).

Priorities. The chattel securities legislation provides that the parties to a security interest may agree that the security will be a legal interest (sec 5) (compared to an equitable interest: eg ¶13-047), and that in the case of a motor vehicle, trailer or boat, the interest first registered on the Vehicles Securities Register has priority (sec 10).

Settling disputes on security interests: extinguishing of security interest. If the "secured party" gives possession of the goods subject to an unregistered security interest to the debtor — under, for example, hire-purchase, sale by instalment or a lease — and if the debtor sells the goods to a third person, the third person obtains clear title to them if the third person bought the goods "for value in good faith and without notice" (sec 7(1)). The security interest is extinguished. It is extinguished even if only part of the purchase price has been paid (sec 7(4)).

The holder of a security interest has all the rights of a seller in respect of any unpaid amount of the purchase price (sec 7(7)).

Where a purchase agreement has extinguished a prior security interest, the rescission of the agreement operates to reinstate the relevant security interest (sec 7(9)).³⁵ (See also ¶14-360.)

A purchase is not "a purchase ... for value in good faith and without notice" if the parties are related (sec 8).

Repossession of fixtures. A further protection to a mortgagee, lessor or owner of goods under hire-purchase is provided by sec 6 of the Act (Vic and WA). This section preserves the right of the credit provider to repossess goods which are the subject of a security interest even though they may have

35. See further, Minister's Second Reading Speech, *Hansard*, Legislative Assembly (Vic), 19 March 1987; Legislative Council (Vic), 28 April 1987; Wilkin, J, *Problems*

of the Chattel Securities Act (1984) 58 LIJ 270; Wilkin, J, *Déjà vu — problems of the Chattel Securities Act — again* (1987) 61 LIJ 937.

become fixtures (§13-080—§13-100). This right is exercisable subject to the obligation to make good any damage done to the land in removing the goods. In other words, as stated by sec 6(1), the effect of the section is to deem fixtures “not to have become fixtures”.

§13-185 Seller’s equitable interest by reservation of title: the Romalpa clause. An effective security for payment in a contract for the sale of goods is by means of a reservation of title, retention of title or Romalpa clause. Under this clause, the seller reserves title or legal ownership over the goods until final payment has been made, and provides that if the goods are sold to a sub-purchaser, the purchaser is to account to the original seller for amounts outstanding. Romalpa clauses are common as a means of protecting sellers, as they provide that if the buyer fails to pay for the goods or goes into receivership (§13-553) or liquidation (§19-600), the seller can repossess the goods.

— *Case example* —

In A’s contract for sale of aluminium foil, A’s terms and conditions included a clause (the “Romalpa” clause) which provided that “[t]he ownership of the material to be delivered [by A] will only be transferred to purchaser [B] when he has met all that is owing to [A], no matter on what grounds”. The contract also provided that if the foil were mixed with other material by purchaser B, the ownership of such objects was to be transferred to A as security for full payment and that until full payment had been made, B held the mixed goods for A as “fiduciary owner”. The contract did allow B to sell the mixed goods but provided that, until final payment had been made for the original foil, B was on request to assign to A the benefit of any claim against sub-purchasers. B went into liquidation, and A’s claim to priority over secured and unsecured creditors in respect of moneys representing the proceeds of sale by B of the unused goods was upheld. Although B had parted with possession it had not parted with legal title to the foil, and hence B was under an obligation to account to A, who was entitled to trace the proceeds of the sales to sub-purchasers and to recover.

— *The Romalpa case*³⁶ —

Romalpa clauses create an equitable interest or charge in favour of the original seller over the assets coexisting with the debtor-creditor relationship, and can be contrasted with an unpaid seller’s lien, which is lost once the seller’s possession of the goods passes to the buyer.

However, Romalpa clauses do lead to the consideration of a number of issues:

- The Romalpa clause must form part of the actual contract between seller A and purchaser B, and is ineffective if it appears on non-contractual documents such as invoices, etc (§16-200).

36. *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 1 WLR 676; [1976] 2 All ER 552.

- If purchaser B is entitled to resell or destroy the goods independently of seller A, title passes to B and the Romalpa clause will fail.³⁷
- Chattel securities legislation enables purchaser B to pass good title to sub-purchasers C who purchase the goods for value and without notice of seller A's interest in the goods (despite the retention of title by A and the prohibition on resale) (¶13-160; ¶14-320ff). However, purchaser B may have committed an offence under the chattel securities legislation.
- The clause may be void as an unregistered bill of sale (¶13-130—¶13-140) or under the Corporations Law as an unregistered charge (¶13-540).
- In the opinion of the Australian Law Reform Commission, there should be a system of registration of reservation of title clauses by lodgment of a single notice against the name of the debtor (customer) to put suppliers, insolvency practitioners, etc on notice.³⁸

¶13-190 Pledges — possessory securities. A pledge is a possessory security. It involves the actual or constructive transfer of possession (not ownership) of goods by one person (the “pledgor”) to another person (the “pledgee”) as security for the payment of a debt or for the performance of an obligation. A pledge involves bailment (¶15-010) and actual or constructive delivery of the subject matter to the creditor/pledgee/bailee.³⁹

When goods are pledged, the owner of the goods (the pledgor) loses possession but not ownership, and the pledgee becomes a bailee (for bailment see ¶15-010). Because the lender takes possession of the goods, a pledge is not a common kind of security.

Constructive transfer of possession may take place, for example, by giving the pledgee the key to a warehouse or a safe in which goods are stored.

Pledge compared to lien: See ¶13-230.

Pledge compared to a mortgage of goods: Compared to a pledge, the mortgagor of mortgaged goods usually remains in possession of the goods. Under some goods mortgages, legal ownership of the goods — but not possession — passes to the mortgagee. (Note that the form of goods mortgage in Victoria and Western Australia (¶13-160) is in line with the position under a pledge — that is, actual ownership remains with the pledgor/borrower.)

Pledge compared to a negative pledge: ¶13-355.

37. Everett, D, *Romalpa clauses: the fundamental flaw* (1994) 68 ALJ 404 and follow-up letter by Professor Palmer at (1995) 69 ALJ 703.

38. ALRC *General Insolvency Inquiry*, Report No 45 (Harmer Report), para 755 (1988).

39. eg *Askrigg Pty Ltd v Student Guild of the Curtin University of Technology* (1989) 18 NSWLR 738 at p 743; (1989) 7 ACLC 1,255 at pp 1,258-1,259.

¶13-200 Position of the pledgor. The pledgor remains the legal owner of the goods pledged. In summary, the pledgor:

- is entitled to demand a receipt for deposit of the goods;
- retains the right to redeem the goods either within the time agreed or within a reasonable time (if no time was specified) and upon reasonable notice;⁴⁰
- can sue the pledgee for negligence (¶4-060ff); and
- can sue the pledgee for the wrongful detention of the goods (under the tort of detinue) if the pledgor is prevented from exercising its right to redeem. Acts by the pledgee which might indicate repudiation of the pledgee's legal obligations under the pledge would include sale of the goods or a sub-pledge for a period longer than the original pledge.

¶13-210 Position of the pledgee. Unlike other security interests, the pledgee/lender acquires possession of the security. Hence, as bailee, the pledgee owes a duty of care in relation to the goods — if the goods are damaged or stolen through the pledgee's negligence, the pledgee must make good any loss. Generally the pledgee has no right to use the goods pledged unless use is beneficial or unless use does not harm the goods. If there is a cost incurred for the keeping of the item pledged (eg an animal), the common law provides that the pledgee may use the milk or ride the horse by way of recompense.⁴¹

Pledgee's power of sale. In the event of default such as non-payment by the pledgor/borrower, the pledgee has the power to sell the goods pledged. The pledgee must make a formal demand for payment following default; the pledgee must give the pledgor notice of the sale; the sale must be a public sale; the pledgee must exercise reasonable care (like the duties of the mortgagee exercising its power of sale: ¶13-045) and the pledgee holds any surplus funds for the pledgor.

The pledgee is not the owner of the goods of the pledgor, yet is able to sell or assign the goods to a third party. This right has been called the pledgee's "special interest" or "special property":⁴²

"... when the nature of the right of a pledgee to sell is examined it will be seen that the so-called 'special' property which it is said to create is in truth no property at all. This has been recognized by many judges who have used the expression 'special interest' ...

In fact, this "special interest" is no more than the pledgee's power of sale on default.

40. *Ex parte Official Receiver; In re Morritt* (1886) 18 QBD 222 at pp 232-234.

42. *The Odessa* [1916] 1 AC 145 at pp 158-159.

41. Paton, GW, *Bailment in the Common Law*, London, Stevens, 1952, pp 369-370.

Pledges and third party rights. The pledgee can assign its interest in the goods to a third party. The pledgee can sue a third party for trespass or conversion of the goods. The pledgee can sub-pledge its interest but not for an amount greater than the original pledge, otherwise the pledgee can be sued for breach of contract. The pledgor cannot sue the sub-pledgee for detinue unless it first offers to redeem the pledge from the pledgee.

A pledge to a third person by a pledgor who has no title or a defective title to the goods pledged remains defective under the rule that “no one can give what he does not have” (the *nemo dat* rule: ¶13-270). If stolen goods are pledged, the pledgee will lose out to the true owner.

¶13-220 Pawn. The words “pledge” and “pawn” are often used interchangeably, although pledges (see ¶13-190ff) to professional pledgees are more usually called “pawns” and are regulated by pawnbrokers legislation.⁴³ A pawnbroker is a dealer in pledges and is licensed to carry on the business of moneylending on the security of the goods pawned.

This area of law introduces the pawnor (the borrower), and the pawnbroker or pawnee (the lender). The regulatory legislation has two main purposes:

- (1) Crime prevention and control. This is achieved by vetting the character of licence holders, imposing obligations on licence holders (eg keeping record books) and giving powers to the police to inspect goods and records. Goods which have been unlawfully pawned may be recovered by the rightful owner by application to a lesser court (a Local/Magistrates’ Court: ¶1-070) for an order for delivery of the goods pawned and/or compensation.
- (2) Consumer protection. The legislation imposes restrictions such as control of interest rates (eg in some jurisdictions a maximum of 48%), exhibiting of interest rate, issue of a pledge ticket, keeping pledges for a minimum of three months (clothing) or six months (other pledges), public auctions, restricted trading hours, and prohibiting taking a pledge from a person under the age of fourteen or a drunk person. The legislation regulates the time and the method of exercise of the pawnbroker’s power of sale.

Pawnbrokers lend about one-third of the market value of the goods pawned. Described as “the bank for the little man”, pawnbrokers offer an

43. eg *Pawnbrokers and Second-hand Dealers Act 1996* (NSW); *Second-Hand Dealers and Pawn-brokers Act 1989* (Vic); *Pawnbrokers Act 1984* (Qld); *1980* (NT); *Second-hand Dealers and Pawnbrokers Act 1996* (SA); *Pawnbrokers and Second-hand Dealers Act 1994* (WA); *Second-hand Dealers and Pawnbrokers Act 1994*

(Tas). The *Pawnbrokers Act 1902* (NSW) applies in the ACT as amended 1995. Section 7(7) of the Consumer Credit Code excludes from most sections of the Code credit provided by a pawnbroker “in the ordinary course of a pawnbroker’s business” (¶14-150).

alternative but expensive source of finance. The legislation goes back a long way and is certainly due for modernisation.⁴⁴

¶13-230 Liens — introduction. A lien is a right of a creditor to retain the goods of a debtor as security for the performance of an obligation. This area of law introduces the lienee (the creditor — the person in whose favour the lien exists) and the lienor (the debtor — the person over whose goods the lien exists). The legal nature of a lien can be further explained by comparison with mortgages of goods and pledges.

Lien compared to mortgage of goods. A lien arises independently of the intention of the parties, compared to a mortgage of goods which arises by the intention of the parties. With a lien, property in the goods remains with the lienor, compared to some mortgages of goods, where property in the goods can pass to the mortgagee.

Lien compared to pledge. A lien arises by operation of law, whereas a pledge arises by the agreement of the parties. A pledgee has a power of sale, but a lienee does not (unless by agreement or under statute). Loss of possession destroys a lien, but does not affect a pledge. Unlike a pledge, a lien generally cannot be assigned, as the lienee's interest is only possession.

¶13-240 Classification of liens. Liens can be classified as those depending on possession by the lienee/creditor (possessory liens) and those not so depending (non-possessory liens). Possessory liens can be further classified as either general or particular (¶13-250), and non-possessory liens (¶13-280) may be equitable, maritime or statutory.

¶13-250 Possessory or common law lien. A possessory lien is a lien depending on the retaining of possession of another's goods by a creditor.⁴⁵ (Sometimes a possessory lien is called a common law lien because it arises independently of statute.) This lien arises when the lienee/creditor already has actual lawful possession of the goods of the debtor, and the right to retain them lasts until a liability (for example, for services rendered) is satisfied. No agreement is necessary between the parties for a possessory lien to arise.

44. As was recommended by the Victorian Law Reform Commission and the Regulation Review Unit, Occupational Regulation — Discussion Paper No 3, *Second-hand dealers, marine stores dealers and pawn brokers*, 1988: *Second-Hand Dealers and Pawnbrokers Act 1989* (Vic).

45. Exercising a lien over papers and refusing to render an account, thereby depriving

a client of the opportunity to pay and discharge the lien, may not be acceptable conduct for a solicitor: Zeeman, WPM, *The termination of a solicitor's retainer* (1988) 117-118 Newsletter of the Law Society of the ACT 18; *Unfair exercise of lien leads to reprimand, fine, costs*, LSJ, Vol 28, No 1, p 31 (February 1990).

A possessory lien may be further classified, by reference to the goods over which it arises, as being of either a general or specific nature.

Particular possessory lien. A particular possessory lien is the right to hold specific or *particular* goods until a debt, in respect of those goods only, is paid. It may arise where the person in possession has worked on the goods, or where a person is compelled to accept and maintain goods on behalf of the debtor (such as an innkeeper or common carrier). An example of the former situation is the case of subcontractors⁴⁶ and repairers.⁴⁷ A mere custodian is not able to exercise a lien and, for example, agistment of horses gives no lien for agistment fees and other expenses unless skill is exercised to improve the animals.⁴⁸ The case law also confirms the right of accountants to assert a particular possessory lien over any books of account, files and papers delivered to them in the course of their ordinary professional work and over documents given to them while acting as agents of their clients, whether or not the books of account, etc delivered to the accountants include actual work carried out by the accountants.⁴⁹ Photocopies of accounting records provided to auditors remain the property of the client company, and although the accountants' or auditors' lien probably extends to these — it certainly extends to notations and actual work done by auditors — any lien is subordinate to statutory rights of inspection such as that of the liquidator of the company or that of the company's receiver ("controller") under sec 431 of the Corporations Law.⁵⁰

The lien of a "common carrier" and a "common innkeeper" is a particular or special lien (¶15-135). A private carrier may have a lien (particular or general) arising either by contract or by statute.⁵¹

General possessory lien. A general lien is the right to hold *any* goods until any debts or charges however arising which are owed to the creditor are paid. This kind of lien is considered to be the exception rather than the rule. As with particular possessory liens, general liens can arise either at common law, by contract or under statute.

Where there is evidence of agreement or trade use and its general acceptance, the law may recognise a general possessory lien arising therefrom. Current usage under contract law now implies a general lien into the continuing

46. eg *Subcontractors' Charges Act 1974* (Qld).

47. Also arises under some statutes: ¶13-280.

48. *Pegasus Leasing Ltd v Cofini*, Supreme Court of NSW, 13 November 1991, unreported, noted [1992] ACL Rep 295 NSW 5, (1993) 67 ALJ 467.

49. *Re Gleebs Pty Ltd (in liq)* [1933] VLR 293; *Woodworth v Conroy* [1976] QB 884; *Vered v Inscorp Holdings Ltd* (1993) 31 NSWLR 290.

50. eg *Re Aveling Barford Ltd* [1988] 3 All ER 1019, noted (1990) 64 ALJ 513 (solicitor's lien over company documents in respect of unpaid costs did not prevent production of documents to company's receiver: receiver not subject to lien).

51. eg railways legislation which provides remedies for default of payment for transportation of goods by rail.

contractual relationships of accountants,⁵² bankers,⁵³ factors, insurance brokers, mercantile agents, solicitors,⁵⁴ stockbrokers, warehousemen, wharfingers and their clients in respect of prior unpaid fees, although the onus of proof is difficult to discharge. The lien only includes the documents of the client, and it does not therefore include the contents of every file. It will arise over documents and goods deposited not for safe custody but in a professional capacity. For example, an unpaid accountant may retain a company's books and assert a *particular* possessory lien in respect of unpaid fees,⁵⁵ and may equally retain a company's books on which the accountant has *not* worked and assert a *general* possessory lien in respect of unpaid fees. However, it has been held that a banker's lien does not extend to moneys held to a customer's credit in a bank account, and furthermore that a banker's lien is not exercisable where there is an express or implied contract between the bank and its customer which is inconsistent with the lien.⁵⁶

¶13-260 Creation of possessory lien by non-owner. Common law principles provide that a lien can only be created by the owner of the goods in question or by a person with the owner's actual or ostensible authority. A third party generally cannot create a lien.

— *Case example* —

A (the "third party" — the plaintiff Protean, the lessee from the owner of an area at the Melbourne abattoir) allotted an area to B (the defendant Randall) as licensee for slaughtering and storage. B slaughtered for various butchers including C. As B owed licence fees to A, A claimed a lien over animals and meat owned by C which were in B's custody. A's claim to a lien over C's property failed, because a third party (A) cannot create a lien. A was never in possession of the animals or meat, and a possessory lien can only be given to a person such as A where that person is in possession with the express or implied authority of the owner (C). There was no evidence at the abattoir of a recognised exception to this rule from usage or trade custom such as would grant A a lien over C's property in the possession of B.

— *Protean Enterprises (Newmarket) Pty Ltd v Randall*¹ —

This common law rule has been altered by hire-purchase and consumer transactions legislation in some jurisdictions² to the effect that where a worker

52. eg Kale, L, *Can I hold the books if the client doesn't pay?*, Australian Accountant, Vol 58, No 1, p 59 (February 1988); ASCPA Ethics Committee, *Accountants' Guide to Liens*, ASCPA, 1995.

53. eg *Duke Finance Ltd (in liq) v Commonwealth Bank of Australia* (1990) 22 NSWLR 236, ¶16-150, ¶16-360.

54. Christensen, S, *Effect on a solicitor's lien of a failure to deliver a bill of costs* (1992) 22 QLSJ 65; *Costs Committee, Solicitor's*

liens, LSB, Vol 18, No 5, p 16 (May 1996).

55. *Woodworth v Conroy* [1976] 1 All ER 107.

56. *MPS Constructions Pty Ltd (in liq) v The Rural Bank of New South Wales* (1980) 49 FLR 430; (1980) 4 ACLR 835.

1. [1975] VR 327.

2. *Hire Purchase Act 1959* (Qld) sec 31; *Consumer Transactions Act 1972* (SA) sec 37; *Hire-Purchase Act 1959* (WA) sec 26; 1959 (Tas) sec 35; ¶14-060.

(a repairer) does work upon goods comprised in a hire-purchase agreement in such circumstances that, if the goods were the property of the hirer, the worker would be entitled to a lien on the goods for the value of the work done, the worker is entitled to a lien notwithstanding that the goods are not the property of the hirer.

However, the lien is not enforceable against the owner if the hire-purchase agreement contains a provision prohibiting the creation of a lien by the hirer and the worker had notice of that provision before doing the work upon the goods.

There is no problem with third party creation of a lien in the case of non-possessory liens: ¶13-280.

¶13-270 Extinction of possessory lien. A possessory lien may be discharged by:

- (1) payment of the amount owing to the lienee;
- (2) agreement to give credit for the amount owing;
- (3) abandonment of the lien;
- (4) acceptance of an alternative security for the amount owing;
- (5) wrongful use or disposition of the lien; or
- (6) loss of possession.

A possessory (or non-possessory) lien over books is not lost if the books are ordered to be produced by the court in proceedings under the Corporations Law (sec 597(10): ¶9-470).

Following amendments starting in 1999, the motor vehicles securities legislation provides that the repairer's lien on goods (whether registered or not registered) ranks in priority over any registrable interest: ¶14-320ff.³

Extinction of possessory lien by loss of possession. Because a possessory lien is by definition dependent upon possession, loss of possession will generally extinguish the lien. Possession must be continuous, but a parting with physical possession for a limited purpose and with a reservation of the legal right to possession may be sufficient to maintain the lien.⁴

— Case example —

The defendant solicitors, who were owed professional fees by the plaintiff, agreed to send to the plaintiff's new solicitors the title deeds to the plaintiff's house, on the understanding that they (the former solicitors) reserved their lien: "these deeds ... are being sent to you on the understanding that you will hold them to our order ...". It was held that the defendant solicitors, although parting with physical possession, had not lost their lien because there was no intention to abandon it or to part with legal possession of the papers.

*Caldwell v Sumpters*⁵ —

3. eg *Registration of Interests in Goods Amendment Act 1999* (NSW) sec 3B; *Chattel Securities (Amendment) Act 1998* (Vic) sec 9.

4. *Albemarle Supply Co Ltd v Hind and Co* [1928] 1 KB 307.

5. [1972] Ch 478; [1972] 2 WLR 412.

This principle was confirmed in 1979. Where a solicitor ceases to act for a client because of unpaid fees, the solicitor's lien is qualified only in that it cannot be exerted so as to interfere with the course of justice.⁶ In other words, the usual practice that papers be handed over against an undertaking that the first solicitor's lien will be respected, was confirmed.

¶13-280 Non-possessory liens. Non-possessory liens do not depend on the lienholder/creditor having possession of the goods of the debtor. These liens include equitable liens, maritime liens, statutory liens and preferable liens (ie liens on crops, wool and stock).

Equitable lien. An equitable lien arises in situations where equity recognises that a creditor has the right to have property of the debtor applied to payment of the debt. Being a lien, it only arises by implication of law, not by express agreement of the parties.⁷ Unlike a possessory or common law lien, an equitable lien does not depend on possession. Examples include:

- A trustee has an equitable lien over trust property for expenses incurred in acting as trustee (¶9-890).
- A beneficiary of a trust has an equitable lien over property bought by the trustee in breach of trust or bought by another beneficiary who has profited by the trustee's breach of trust (¶9-930).
- An unpaid vendor of a house or land who has given possession or title to the purchaser has an equitable lien over the property for the amount unpaid (as in *Heid's case*: ¶13-270 and *Bridgewater's case*: ¶15-730).
- A purchaser of a house or land who has paid a deposit has an equitable lien over the property to the extent of the purchase money paid. In *Hewett v Court*,⁸ it was held that the equitable lien of a purchaser of a transportable home did not constitute a preference in the bankruptcy proceedings of the vendor.
- A partner on dissolution of partnership has an equitable lien over the partnership assets to ensure the assets are used to meet partnership debts (¶10-580).
- *Lien over costs order.* Where a solicitor has obtained a court order for legal costs and has no chance of obtaining payment, the solicitor has an equitable lien or an equitable charge (¶13-048) over funds of the client held for costs.⁹ The solicitor's equitable lien takes priority over a

6. *Gamlen Chemical Co (UK) Ltd v Rochem Ltd* [1980] 1 All ER 1049.

7. Technically, an "equitable lien" arises by implication of law, whereas an "equitable charge" (¶13-048) arises by express or implied intention. In practice, these terms — and "charging order", "equitable assignment", "equitable interference", and "equitable right" — are sometimes used

loosely and interchangeably. The court order in the *Akki case* (below) was described as both an equitable charge and an equitable lien.

8. (1983) 149 CLR 639; (1983) 1 ACLC 768.

9. *Akki Pty Ltd v Martin Hall Pty Ltd* (1994) 35 NSWLR 470.

purported assignment (¶13-340) and it does not contradict a property order made by a court.¹⁰

The licensee can apply to the court to exercise its power of sale and/or for a court order to appoint a receiver.

Maritime lien. A maritime lien is a right which attaches to a ship and its cargo in connection with a maritime liability. Possession is not necessary; the lien attaches regardless of any change in ownership because the lien is exercised against the ship, not the owners. It may be exercised by stopping the ship. Examples of maritime liens include the lien of seamen for their wages, the lien of a master for salary and for disbursements made, and liens which arise in favour of claimants regarding damage in a collision.

Statutory lien. Statutes may create liens, codify an existing common law lien, add additional powers or make statutory a lien which may have arisen by contract. Examples of statutory liens include:

- The warehousemen's lien. Because a warehouseman does not actually carry out work on goods stored, a warehouseman may not be entitled to claim a possessory lien (see ¶13-250). The applicable legislation¹¹ makes the warehousemen's lien statutory and creates a power of sale.
- The unpaid sellers' lien, which arises when the unpaid seller retains possession of the goods (there is no right to regain possession) (¶7-030).¹²
- The workers', repairers', contractors' and/or subcontractors' lien.¹³
- The innkeepers' lien. Statutes in some jurisdictions add a power of sale of goods of an absconding guest or lodger to the innkeeper's common law lien.¹⁴
- The general statutory power of sale of a bailee for reward¹⁵ (¶15-040; ¶15-200).
- The Civil Aviation Authority's statutory lien over aircraft for amounts owing for service and facilities provided to airline operators.¹⁶

10. *Color Point Pty Ltd v Markby's Communication Group Pty Ltd* [1998] FCA 1516.

11. eg *Warehousemen's Liens Act 1935* (NSW); 1952 (WA); 1969 (NT); *Storage Liens Act 1973* (Qld); *Mercantile Law Act 1962* (ACT), Pt VI.

12. (*Sale of Goods Act 1958* (Vic) sec 47; 1923 (NSW) sec 43; 1896 (Qld) sec 42; 1895 (SA) sec 40; 1895 (WA) sec 40; 1896 (Tas) sec 45; 1972 (NT) sec 43; 1954 (ACT) sec 44.

13. eg *Contractors' Debts Act 1893* (NSW); *Subcontractors' Charges Act 1974* (Qld);

Unclaimed Goods Act 1987 (SA); *Worker's Liens Act 1893* (SA), which also applies in the NT, applied, eg, *Packer & Co Pty Ltd v Aksha Pty Ltd* (1996) 12 BCL 143.

14. eg *Licensing Act 1967* (SA) sec 121.

15. eg *Uncollected Goods Act 1995* (NSW); *Disposal of Uncollected Goods Act 1967* (Qld); 1970 (WA); 1968 (Tas); 1976 (NT); *Unclaimed Goods Act 1987* (SA). See further Peden, JR, *Licensee's statutory power of sale* (1968) 6 UQLJ 24.

16. eg *Airservices Australia v Canadian Airlines International Ltd* (1999) 74 ALJR 76.

- “Statutory charges” over land in favour of statutory authorities where there are unpaid rates, land taxes, etc. Securities over crops and other forms of farm financing are also sometimes called “statutory charges”. Technically none of these are liens, as possession does not pass to the creditor. They should all be classified as statutory charges: ¶13-048.

¶13-290 Enforcement of lien. In summary, and as noted above, the various classes of liens can be enforced as follows:

Possessory lien. Unless there is express agreement or statutory authority, a possessory lien does not give a power of sale. Indeed, a possessory lien may lead to expenses — such as garaging a car over which a repairer may have exercised a lien — but no charge may be made for these expenses. As noted at ¶13-270, a possessory lien may be lost by loss of physical possession of the goods (even if the goods later come back to the lienor).

Equitable lien. The equitable lien of a trustee, partner, etc is enforceable by a court order under the lienor’s power of sale and/or by a court order to appoint a receiver.

Maritime lien. A maritime lien is exercised against the ship itself. If a ship subject to a lien is sold, the purchaser takes the ship subject to the lien.

Statutory lien. The gist of the statutory lien is generally the creation of a power of sale where one would otherwise probably not exist, bearing in mind that a lienor has no power of sale at common law. Enforcement of a statutory lien by a creditor gives the creditor priority over other creditors if the debtor is bankrupt or insolvent.

¶13-300 Farm financing — crop liens, wool liens and stock mortgages. In view of the importance of rural production in the Australian economy (accounting for approximately half of Australia’s export income) it is appropriate to examine how the law has provided for its financing on the security of crops, wool and stock. Securities over crops, wool and stock are provided for in legislation in each jurisdiction which provides that the security is a statutory security — either a statutory charge or a statutory lien.¹⁷ The general purpose of this legislation is to facilitate farm credit by confirming the legal quality of the available security interest rather than to invalidate secret and unregistered securities. In general, State and Territory legislation provides that securities concerning stock and crops

17. Corporations Law sec 262(5); *Instruments Act 1958* (Vic) Pt VII and VIII; *Liens on Crops and Wool and Stock Mortgages Act 1898* (NSW) Pt II and III; *Liens on Crops of Sugar Cane Act 1931* (Qld); *Bills of Sale and Other Instruments Act 1955* (Qld) Pt 2 and 4 (other than sec 24); *Bills of Sale Act 1886* (SA); *Liens on Fruit Act*

1923 (SA) and *Stock Mortgages and Wool Liens Act 1924* (SA); *Bills of Sale Act 1899* (WA) sec 7 and Pt IX-XI; *Bills of Sale Act 1900* (Tas) sec 36; *Stock, Wool and Crop Mortgages Act 1930* (Tas); *Instruments Act 1933* (ACT) Pt IV and V; *Instruments Act 1935* (NT) Pt III and IV.

may be invalid or adversely affected in some other way by the absence of registration; the State and Territory legislation must be read with sec 262(1)(h) of the Corporations Law which requires the registration of crop liens, wool liens and stock mortgages issued by companies (§13-540). However, to overcome the need for dual registration (in the case of companies), sec 273 of the Corporations Law provides that where registration is required under sec 262(1)(h), the charge need not be registered under the relevant State/Territory law, the charge will not be affected by State/Territory priorities provisions and the validity of the charge will not be affected by the failure to register it under State/Territory legislation.

Without legislative backing, a security over a crop yet to be grown could only be effective as an equitable mortgage. Until harvest, crops are not "articles capable of complete transfer by delivery" and could not properly be the subject of a bill of sale (because the subject matter of a bill of sale is "personal chattels": §13-100). Generally the lien must be in the prescribed form and must be registered and available for public inspection. The effect of the lien is that the ownership of the crop upon harvest passes to the lienee to the extent that is necessary for repayment of the advance and the agreed interest. On default, the lienee will have the right to enter upon the lienor's land and harvest the crop. The legislation also settles the question of priorities between competing creditors, with absolute protection for the crop lienee from the lienor's trustee in bankruptcy, unsecured creditors, purchasers of the land, claims of the lienor's landlord and (with some qualification) mortgages of the land itself.

Unlike crop and wool liens, which are special securities created by statute, a stock mortgage is a mortgage already recognised at law and in equity. The purpose of stock mortgage legislation, which post-dates bills of sale legislation, is to provide added security to the farmer seeking finance by giving extra firmness to what may be seen as a weak security. As the farmer remains in possession of the security, registration of a stock mortgage in the form provided by the legislation with the Registrar-General (or equivalent) provides public notice of the existence of the security.

Priorities are dealt with as with bills of sale such that an unregistered stock mortgage is valid as against bona fide purchasers but is invalid as against judgment creditors and the trustee in bankruptcy.

§13-330 Lending on security of choses in action. A chose in action is another name for intangible property (§13-040). The term is often used to describe such items as book debts, shares (marketable securities), contractual rights, bills of exchange, policies of insurance and similar interests. In many modern commercial situations a chose in action will be an extremely valuable item of property, which may be the basis of a particular business person's or company's arrangements. Many such persons will use choses in action, especially items such as book debts or shares, to finance particular activities.

§13-330

Financing of book debts has become an important method of carrying on business in recent years. Such financing has also had an important part to play in tax planning schemes involving professional people.

¶13-340 Assignment of choses in action. An assignment is a transfer of ownership. An assignment of non-physical property (a chose in action) may take place for various reasons such as for a security or for tax minimisation (by transferring ownership of an income-producing asset). An assignment may cover the following.

Legal choses in action such as contracts (¶6-275), negotiable instruments (cheques and bills of exchange) or intellectual property (¶13-040).

A legal chose in action may generally be assigned by a simple statutory form. The relevant terms of the *Conveyancing Act 1919* (NSW) (sec 12)¹⁸ are as follows:

“Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other legal chose in action, of which express notice in writing has been given to the debtor, trustee, or other person from whom the assignor would have been entitled to receive or claim such debt or chose in action, shall be, and be deemed to have been effectual in law (subject to all equities which would have been entitled to priority over the right of the assignee if this Act had not passed) to pass and transfer the legal right to such debt or chose in action from the date of such notice, and all legal and other remedies for the same, and the power to give a good discharge for the same without the concurrence of the assignor: Provided always that if the debtor, trustee, or other person liable in respect of such debt or chose in action has had notice that such assignment is disputed by the assignor or anyone claiming under him, or of any other opposing or conflicting claims to such debt or chose in action, he shall be entitled, if he thinks fit, to call upon the several persons making claim thereto to interplead concerning the same, or he may, if he thinks fit, pay the same into court under and in conformity with the provisions of the Acts for the relief of trustees.”

The effectiveness of an assignment of a legal chose in action will depend on how far the assignor has satisfied the requirements contained in the statutory provision set out above. Failure to complete all of these matters may result in an assignment only valid in equity and not in law.

A legal chose can be assigned in equity. The High Court has held that an assignment takes effect in equity if the donor (the assignor) has done all that was necessary (not just all that was possible) to be done.¹⁹

Assignment of future property. Future property is not strictly assignable at common law or in equity, but if an attempted assignment of future property

18. The equivalent provisions in the other jurisdictions are: *Property Law Act 1958* (Vic) sec 134; *Property Law Act 1974* (Qld) sec 199; *Law of Property Act 1936* (SA) sec 15; *Property Law Act 1969* (WA) sec 20; *Conveyancing and Law of Property Act 1884* (Tas) sec 86; *Law of*

Property (Miscellaneous Provisions) Act 1958 (ACT) sec 3 (which applies the NSW Act); *Property Act 1860* (SA) sec 19, in force in the NT.

19. *Corin v Patton* (1990) 169 CLR 540; ¶13-220.

is made for valuable consideration, the court in equity will assist the purported assignee by enforcing the agreement as binding in equity.²⁰ A chose in action may not be assigned gratuitously in equity because it is a mere expectancy or possibility. The principles relating to voluntary assignment of future property are discussed in the following two leading tax cases.²¹

— *Case examples* —

In 1956 a taxpayer purported to assign by deed to his wife by way of gift all the interest derived during the year of income ending 30 June 1958 from a sum of £3,000, being part of a sum deposited by him on loan with a firm. The loan was for no fixed term and the firm was at liberty to repay it or any part of it at any time without notice. The majority of the court held that when the deed was executed the future interest on the sum of £3,000 was merely an expectancy or possibility which could not be effectively assigned without consideration, and accordingly the interest when received was assessable income of the taxpayer.

— *Norman v FC of T*²² —

A taxpayer was entitled under a licence agreement to royalties directly proportionate to the number of products manufactured. By a deed he then purported to assign by way of gift absolutely and unconditionally to persons whose names were there set out all his "right title and interest in and to an amount equal to ninety per cent of the income which" might accrue during a period of three years under the licence agreement.

It was held by the court, who considered *Norman v FC of T* but thought this case was different, that on its true construction the deed was not an attempt to assign expectancies or a covenant to assign future property but was a present assignment of an existing chose in action. Accordingly the proportion of the royalties paid during a year of income to the named persons was not part of the assessable income of the taxpayer.

— *Shepherd v FC of T*²³ —

Equitable choses in action. An equitable chose in action (such as an interest in a partnership: *Everett's case* ¶3-040, ¶10-480) can only be assigned in equity.

The only requirement for the valid equitable assignment of an equitable chose in action is the expression of an intention to assign. There appears to be no specific language that has to be used. Nor is it necessary for consideration to pass. However where the assignment is of existing equitable choses in action then it would appear that the only safe way to achieve this is to put

20. 17 TBRD Case S2 at p 11.

22. (1963) 109 CLR 9.

21. *Everett's case* (1980) and *Hadlee's case* (1993) dealing with assignment of partnership income for income-splitting are set out at ¶10-480.

23. (1965) 113 CLR 385.

the particular assignment in writing. This flows from statutory provisions in all jurisdictions.²⁴

An equitable chose in action may be assigned under the legislation above.

A legal or equitable chose in action cannot be assigned at common law, but it may be assigned under the legislation above.

Statutory requirements for assignment of specific choses in action. There are specific statutory provisions regulating the assignment of certain types of choses in action. Book debts comprise a special form of chose in action (cf ¶13-330). Company shares are required to be assigned specifically under the terms of companies legislation. Industrial property (such as patents, trade marks, etc) is specifically covered by provisions of Commonwealth legislation.²⁵ Each of these legislative provisions sets out a simple form of assignment which must be followed by the assignor.

¶13-350 Floor plan financing. Stock-in-trade, cash flow, inventory, receivables or liquidity financing enables a business — especially a motor vehicle dealer — to repay the amount borrowed from the sale of the goods or services financed. (These are examples of commercial leasing, bailment arrangements or hire-purchase at common law, discussed further at ¶14-065.) The most common example of this is floor plan, bailment, display plan or wholesale finance where finance company A agrees to buy stock from retailer B in consideration of say 90% of the price paid by B, and B is to repay the advance and interest on the later sale of the security itself. Ownership (“property”) passes to A while B retains possession. An alternative floor plan involves an advance by the financier in the form of an equitable mortgage secured by a registered charge over stock (¶13-047 — ¶13-048).

Stock-in-trade financing can give rise to competing claims of ownership between A and an innocent purchaser C. Sale of goods legislation in all jurisdictions provides exceptions to the *nemo dat* rule (that a person cannot give what he does not have) when it provides for transfer of title by non-owner B to innocent purchaser C in certain circumstances: ¶7-020.

Stock-in-trade financing has been affected by legislation in all jurisdictions setting up title security systems for motor vehicles. The legislation (see ¶14-320) has altered the common law rules governing competition between a secured party (mortgagee, lessee or hirer of goods) and a subsequent purchaser of an interest in the goods for value in good faith and without notice of the prior security interest, by providing for registration of security interests in motor vehicles as a warning of an existing interest to a subsequent

24. *Conveyancing Act 1919* (NSW) sec 23C(1)(c); *Property Law Act 1958* (Vic) sec 53(1)(c); *Property Law Act 1974* (Qld) sec 11(1)(c); *Law of Property Act 1936* (SA) sec 29(1)(c); *Property Law Act 1969* (WA) sec 34(1)(c); *Conveyancing and*

Law of Property Act 1884 (Tas) sec 60(2)(c).

25. *Patents Act 1990* sec 14; *Trade Marks Act 1955* sec 82; *Designs Act 1906* sec 25C; and *Copyright Act 1968* sec 196.

purchaser. Failure to register may result in the extinguishment of the security interest (§13-160, §14-320—§14-360).

§13-355 Negative pledge. A negative pledge is a contractual undertaking by a borrower to a lender under which the borrower restricts its right to further borrowings. If the lender is unsecured, the aim of the negative pledge is to ensure that the borrower's assets remain unsecured. If the lender has security, the aim of the negative pledge is to prevent another lender from gaining priority.

A negative pledge does not give the lender any security interest in the property of the borrower, and its remedies are in contract.

§13-360 Guarantees and suretyship. A lender providing finance for a company or other business will usually require some form of security to ensure that the loan is protected, such as personal guarantees by management, in addition to the securities given by the company or business. This requirement is reasonable in view of the capitalisation of so many companies by the issue of a nominal number of shares at a nominal value (like the issue of two \$1 shares) such as companies set up as the trustee of a trust (§9-790; §9-885). Yet a company may be operating with assets worth many times the value of its potential nominal capital and its directors may be contracting debts, dealing in assets and involving their company in liabilities far in excess of the capital of the company. Although there are exceptions to the basic principle that a company is a separate legal entity (as set out at §9-460), lenders will often ask for personal guarantees from individual directors, and from major shareholders in the case of closely held or family companies.

Guarantee: definition. A guarantee is a contract to answer for the debt of another, such as a car buyer's parents promising to pay the creditor under a car finance contract if the son or daughter defaults. More formally put, a guarantee is a contract made by one person (A — the promisor on the guarantee contract — the guarantor or surety) with another (B — the promisee on the guarantee contract — the creditor) to pay a debt or to perform an obligation of a third person (C — the debtor, the principal debtor or the principal on the principal contract) who has or who is expected to have a primary liability to the creditor.

To enforce its debt or obligation, the creditor (B) can sue the principal debtor (C) for the contract debt because the debtor's liability is primary, or the creditor can sue the guarantor (A) on the contract of guarantee as the guarantor's liability is secondary.

Guarantee or indemnity. A contract of indemnity is another means whereby a person's obligation can be secured by another person's entering an obligation to pay. In contrast to a guarantee, the promisor intends to become directly responsible to the promisee. Under an indemnity, one person (A — the promisor, indemnifier or surety) undertakes to become directly responsible to the promisee (B — the person indemnified) for the action of C. To enforce

its debt or obligation, promisee B cannot sue the debtor (C), because B and C have no direct legal relationship, and can only sue the promisor (A) under the indemnity.

The difference between guarantee and indemnity is important because:

(1) In a contract of indemnity the indemnifier (A) is under primary liability, whereas in a contract of guarantee the principal debtor (C) is primarily liable while the guarantor (A) is under secondary liability if the debtor defaults. In other words, because a guarantee arrangement involves three parties, it gives rise to primary and secondary liability, whereas there is only primary liability under an indemnity.

(2) In the jurisdictions where it applies, the *Statute of Frauds* requires contracts of guarantee to be evidenced in writing whereas contracts of indemnity can be oral (§15-030).

In its widest sense, a contract of indemnity includes a contract of guarantee. The word “surety” includes both guarantor and indemnifier, but where appropriate in this discussion the generic “guarantee” is used to cover contracts of both guarantee and indemnity.

Essentials of a guarantee. Apart from the *Statute of Frauds* requirement of evidence in writing just noted, the other major formal requirement affecting guarantees may be the Consumer Credit Code if obligations under a credit contract are guaranteed and the guarantor is a natural person or a strata corporation (sec 9). If applicable, this legislation requires writing signed by the guarantor and other important formalities before a regulated contract can be enforceable: §14-180.

In addition, a guarantee must fulfil all the requirements of a valid contract (§15-020).

The operation of the guarantee itself is a matter of negotiation, and it may be retrospective or prospective, limited or unlimited, conditional or unconditional, continuing with divisible consideration or continuing with indivisible consideration.

As discussed below, a guarantee may be set aside on grounds such as misrepresentation, undue influence and unconscionability but a guarantee is not in itself a contract of the utmost good faith (as is an insurance contract: §17-310).

§13-370 Rights and liabilities of guarantors

Guarantor's liability. The guarantor is not liable to the creditor until there is an accrued liability such as default by the principal debtor. For example, in one case a guarantor's liability under a real estate contract to guarantee performance by the purchaser “upon settlement” did not commence because there was no settlement, due to the purchaser's purported rescission.²⁶ There

26. *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245; (1988) 62 ALJR 195.

is no implied condition precedent that the creditor is to give notice of the debtor's default or that the creditor must first sue the debtor. Once liable, the guarantor's liability must be the same as that of the debtor because the guarantor's liability is co-extensive with that of the debtor. If the debtor is a minor, the guarantor is still liable on the guarantee: ¶5-520.

The conduct of the guarantor may be "misleading or deceptive" under sec 52 of the *Trade Practices Act 1974* (Cth) or *Fair Trading Act* equivalents.²⁷

The guarantor's liability arises when the principal debtor defaults; the guarantor is not entitled to any cross-claim available to the debtor against the creditor.

The duration of the guarantor's liability depends on the agreement — some guarantees are limited to a single transaction, and others, called continuing guarantees, cover a number of transactions over a period of time.

Although the relationship of creditor/guarantor is not normally based on utmost good faith (¶17-310) and is not normally fiduciary (¶9-770), there are a number of potential defences to liability open to a guarantor:²⁸

- Principal contract unenforceable. If the contract between lender and debtor is void, voidable or unenforceable — such as a claim for moneys which is void because it is unenforceable against the debtor as a penalty (¶6-490) — the contract of guarantee will also be unenforceable against the guarantor.²⁹
- Misrepresentation: ¶5-700.
- Undue influence, as in *Lloyds Bank v Bundy*: ¶5-710.
- Unconscionability, in equity as in *Amadio's case* (¶5-730), under sec 51AA-51AB of the *Trade Practices Act 1974* (¶5-755)³⁰ and *Fair Trading Act* equivalents (¶5-760), and under the *Consumer Credit Code* (¶14-240).

27. eg *Brueckner v Carroll* (1995) ATPR ¶41-379 (purported guarantor's conduct not misleading as he did not induce borrower to believe he would guarantee the borrower's transaction); ¶7-280; *Australian Securities and Investments Commission Act 1989* (Cth) sec 12DA does not apply to guarantees: ¶7-240.

28. eg Moon, G and Swart, E, *How to get out of a contract of guarantee*, Melbourne, Consumer Credit Legal Service, 1991; McDonald, J, *Sexually transmitted debt — can it affect you?* (1991) 105 *The Australian Banker* 72; Sneddon, M,

Lenders and independent solicitors' certificates for guarantors and borrowers: risk minimisation or loss sharing? (1996) 24 *ABLR* 5.

29. eg *Citicorp Australia Ltd v Hendry* (1985) 4 *NSWLR* 1, ¶6-490.

30. The parallel unconscionability provisions in the *Australian Securities and Investments Commission Act 1989* (Cth) sec 12CA, 12CB do not apply to guarantors as they are limited to a "financial product", the definition of which does not include a guarantee (¶5-755).

Guarantor's rights against creditor. Before payment to the creditor, the guarantor can require the creditor to approach first the principal debtor for payment. If this is unsuccessful and if the guarantor is required to pay, the guarantor is subrogated to the creditor's rights and can "stand in the shoes" of the creditor to sue the principal debtor for indemnity. This includes the right to enforce all the rights of the creditor over the debt including an assignment of all judgments and securities of the creditor over the debt.

The creditor is under a duty to protect the interests of the guarantor by not modifying the principal contract without the express or implied agreement of the guarantor, but as yet there is no duty to maximise the guarantor's position. However, the creditor must not recklessly risk the position of the guarantor. The law expects of the creditor reasonable protection of the debtor's property and reasonable sale and realisation by the creditor of the debtor's property.

Guarantor's rights against principal debtor. The guarantor can claim an indemnity from the principal debtor, which becomes a debt due once the guarantor has paid the creditor. After payment of the guarantee, the guarantor has a right against the debtor for exoneration known as its "equity of indemnity". If required to pay the creditor, the guarantor is subrogated to the creditor's rights to sue the principal debtor for indemnity (compare subrogation in insurance: ¶17-920). If sued by the creditor, the guarantor can issue a third party notice against the debtor to claim an indemnity from the debtor.

Guarantor's rights against co-guarantor. On the basis of natural justice and fairness, the law provides that a guarantor is entitled on equitable principles to contribution from co-guarantors in proportion to the amount guaranteed.

— *Example* —

Assume that there are three co-guarantors of C's debt of \$30,000. If A1 has paid \$10,000, A1 has no right of contribution and A2 and A3 remain liable for \$10,000 each. If A1 has paid the whole \$30,000, A1 can claim contribution from A2 and A3. If A2 is unable to contribute, for example due to bankruptcy, A1 can claim \$15,000 from A3.

Contribution cannot normally be avoided in the case of the same debt, as guarantors are bound jointly, jointly and severally (ie separately), or severally, whether by the same or different documents, and whether or not they knew of each other.³¹ But contribution may be avoided if the circumstances indicate that the parties did not intend to become co-guarantors, for example by expressly contracting to be individually liable for their own share.

31. eg *Mahoney v McManus* (1981) 55 ALJR 673 at p 675.

¶13-380 Discharge of guarantee. A guarantor will be discharged from obligations under the guarantee and the guarantee will be terminated by:

- (1) Payment, when the principal discharges the guaranteed debt.
- (2) Unenforceability of the primary obligation due to unconscionability etc, as discussed above at ¶13-370.
- (3) Variation of the principal contract between the creditor and debtor of a kind which could prejudice the guarantor. Also, any “material” alteration to the guarantee without the express or implied agreement of the guarantor discharges the liability of the guarantor.

— *Case example* —

In breach of a contract of guarantee, the owner of leased machinery (the creditor) failed to notify the guarantor when the lessee (the debtor) both defaulted under the contract and assigned its interest in the machinery. The High Court confirmed that these breaches by a creditor of promissory terms of the guarantee requiring strict performance discharged the guarantor from liability.

— *Ankar Pty Ltd v National Westminster Finance Australia Ltd*³² —

Other examples of variation affecting the validity of the original guarantee include various failures by the creditor such as failure of consideration (failure of the creditor to carry out a promise); failure of a condition precedent (such as failure to find a co-guarantor); non-compliance with a condition, and non-disclosure, misrepresentation and/or fraud by the creditor (such as concealment of valuations). Another example of variation is extension of time by the creditor for payment without the consent of the guarantor.

A guarantee is also discharged by alterations to the liability of the guarantor such as the factors rendering a guarantee unenforceable or a creditor releasing a co-guarantor from liability. Because the creditor is under a duty to protect the guarantee from alteration, any material alteration to the guarantee or any interference with or loss of the security (for example, to lower its value), without the guarantor’s consent, will discharge the guarantor.

- (4) Revocation. A continuing guarantee with divisible consideration — eg goods supplied and to be supplied — is normally revocable regarding liability for future transactions (ie goods to be supplied), and if allowed by the guarantee, a guarantor can revoke a single guarantee by notice, agreement, waiver and/or novation (substituting a new contract). This revocation does not discharge the guarantor from liability which has already accrued. In contrast, if the consideration for the guarantee is indivisible and has been executed by the creditor (ie past consideration), the guarantee cannot be revoked without the consent of the creditor.

32. (1987) 162 CLR 549; (1987) 61 ALJR 245, noted (1987) 61 ALJ 364; ¶6-095.

(5) A change in the constitution of a partnership (in the absence of an agreement to the contrary) in the case of a continuing guarantee given by a firm: see ¶10-360.

(6) Death of the guarantor. If the guarantor dies, in the case of future debts under a continuing guarantee, the estate of the deceased guarantor will not be bound (unless the guarantee provides otherwise). The death of one co-guarantor does not discharge the liability of the others.

COMPANY FINANCING

Advantages and disadvantages of a company

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¶13-390 Advantages and disadvantages of a company for credit purposes. The corporate structure may present some problems for those who choose to operate through a company. Because a company is a separate legal entity recognised by the law as being distinct from its incorporators or its members (¶5-570; ¶9-460), indebtedness created is between the lender or credit provider and the company rather than the individual members of the company. Enforcement lies not against the individual members (unless there are personal guarantees — ¶13-360) but against the company itself.

A company has all the powers of a natural person, and is not limited to the specific “objects” set out in its constitution (¶9-430). A lender is entitled to assume that all internal regulations of a company have been complied with (unless the lender has actual knowledge to the contrary: ¶9-470).

A company offers a number of advantages to borrowers over other forms of business organisation:

- (1) A company is a familiar commercial structure, regulated by the Corporations Law which is administered by the Australian Securities and Investments Commission (¶9-380).
- (2) A company may be preferred as a borrower over—

- a partnership, because the identity of the borrower is certain and does not vary with changes in its membership;
- a trust (eg the trustee of a trading trust), especially where the trustee is a \$2 nominee company of no substance in its own right (§9-790; §9-885) because of the real scope provided by the trust form to frustrate creditors (§9-900).

¶13-400 The stock market. A stock market is a market, exchange, place or facility for the buying and selling of securities—such as company shares (§13-430ff), debentures (§13-480) and units in a managed investment scheme (§13-550)—where prices are set by the laws of supply and demand. Securities bought and sold on a stock market are issued by listed public companies (§9-350).

A stock market provides for the transfer of funds from savers to users in the *primary market*, the transferability of securities in the *secondary market*, and anonymity and uniformity in trades:

- (1) The primary or new issue market. The function of this market is to provide the long term funds required by business and government. The issuer of securities such as shares (with the prospect of dividends and capital gain) and notes, debentures or bonds (with the prospect of interest) can attract people's savings in the form of investment.
- (2) The secondary market. Existing securities as defined in the Corporations Law sec 92, 92A are bought and sold on the secondary market. This market is essential to the existence of a healthy primary market, as few would commit their funds for long term use by business without the opportunity to sell later in the secondary market. Thus the degree of efficiency in the trading and the new issue markets must have a direct influence on the economic climate and potential of the country.

In a free enterprise system, funds and real resources will flow not according to some government's central plan but according to the business judgment of thousands of investors who will seek the most profitable opportunities. The prices in the secondary market will reflect this business judgment, and companies whose prospects are widely judged to be good will find that their shares command high prices and correspondingly low yields in the market. They will find funds easy and cheap to obtain. The secondary market, by enabling investors to switch their savings from one company to another, provides a continuous test of company efficiency and profitability.

A stock market reduces transaction costs for buyers and sellers (because they do not have to deal direct).

Stock market regulation seeks to achieve:

- an efficient market, with efficient allocation of resources — resources flow to their most useful end (allocative efficiency). A company whose product is in demand has a "high price" because of its expected future profits;

- a competitive market (§8-040); and
- an informed market, where prices reflect the available information (informational efficiency). For this reason, a stock market is said to be a market for information.

The Rae Report's recommendation in 1974³³ of a national stock exchange having the confidence of investors came to fruition on 1 April 1987 when the six capital city stock exchanges merged to form the Australian Stock Exchange Ltd ("ASX") (background at §8-660). The six capital city exchanges are now subsidiaries of ASX which was a corporation limited by guarantee (§9-290) and which "demutualised" in 1998 into a company limited by shares (§9-280). Each one is called the Australian Stock Exchange (name of capital city) Ltd, eg the Australian Stock Exchange (Sydney) Ltd.

The sponsoring legislation also provided for a National Guarantee Fund, replacing the fidelity fund of each capital city exchange.

Uniformity throughout Australia in the regulation of the securities market generally is one of the chief aims of the Corporations Law contained in the *Corporations Act 1989* (Cth) (noted in more detail at §9-370—§9-380).

§13-420 How the stock market works. Once an investor decides to buy or sell shares, the order is placed with a stockbroker. It can be placed with limits — for example, "buy up to \$1" or "sell at \$5 or more" — or the stockbroker may be given the discretion to deal "at market" or "at best".

Some stockbrokers confine their activities to acting as agents for clients who wish to buy or sell securities, while others offer a wide range of services: research and investment advice, underwriting new issues of shares, and advising companies on finance, takeovers and investment.

After shares have been sold, the buyer will receive from its stockbroker a "contract note" showing details of the purchase, brokerage payable (the negotiable commission the stockbroker charges (§8-660)), stamp duty and the final amount due. The seller of the shares receives a "sold contract note" from its stockbroker. This shows details of the transaction and the net proceeds from the sale. Uncertificated and electronic securities transfers were introduced in 1989.

What can be bought and sold on the stock market. Securities traded are divided into two broad categories — fixed interest securities and ordinary shares.

Fixed interest securities are loans — to governments, semi-government authorities or companies. They get a fixed rate of interest and are repayable at a fixed maturity date. Commonwealth government loans carry the lowest interest rates, followed by semi-government loans and company debentures and unsecured notes.

33. Senate Select Committee on Securities and Exchange (Chairman: Senator P Rae),

Australian Securities Markets and their Regulation, AGPS, 1974.

Ordinary shares give the holder a share in the business. Most shares (except preference shares, which have a fixed dividend rate) receive dividend payments depending on profits. The Australian Stock Exchange also trades options to take up shares and rights to new issue shares. Derivatives (“futures”) are traded on the Sydney Futures Exchange, one of the world’s leading futures exchanges.

¶13-430 Share issues. While it is common for public companies (¶9-350) to “float” new issues, either of shares or debentures or unsecured notes, the private or proprietary company, which represents 90% of business undertakings through the company form in Australia, cannot make a public issue (Corporations Law sec 113) (¶9-340).

Before the 1 July 1998 amendments to the Corporations Law, shares were issued at par (their nominal or face value) or at a premium (where the issue price exceeded par). Although the nominal value fixed the maximum amount that a shareholder may have had to pay by way of statutory liability, the concept was arguably misleading (as par value was often different from market value); it complicated adjustments of share capital and inhibited a company wishing to raise new capital (if the shares had a market value below par).

The share capital rules were simplified by the *Company Law Review Act 1998*. These changes included removing the concept of par value (sec 254C) and improving the procedures for returning capital to shareholders. These changes were based on maintaining the solvency of the company, ensuring fairness among shareholders and disclosure of all material information to provide better protection for shareholders and creditors.

¶13-440 Financing dealings in own shares. A basic feature of company law in Australia for over a century was the prohibition on a company’s dealing in its own shares.³⁴ Reasons for this prohibition were that:

- the Corporations Law indicates a clear intention that a company’s capital be maintained, subject to a statutory procedure for reduction;
- as shareholders are exempt from personal liability for the debts of the company, they rank behind the company’s creditors on the list of persons entitled to claim on the assets of a company in liquidation;
- the company’s capital should be maintained in the interests of creditors.

New financial assistance provisions were introduced into the Corporations Law on 1 July 1998 (Part 2J.3). Section 260A allows a company to financially assist a person to acquire shares in the company (or a holding company of the company), but only if:

- the assistance does not materially prejudice the interests of the company or its shareholders, or the company’s ability to pay its creditors; or

34. *Trevor v Whitworth* (1887) 12 App Cas 409.

- the company obtains shareholder approval for the financial assistance (see sec 260B); or
- the assistance is:
 - a reduction of share capital in accordance with Div 1 of Pt 2J.1;
 - a share buy-back in accordance with Div 2 of Pt 2J.1;
 - given under a court order;
 - a discharge on commercial terms of an ordinary commercial liability (see sec 260C).

¶13-460 Permitted share buy-backs. The Corporations Law recognises eight permissible categories of buy-back:

- minimum holding buy-backs (ie buy-backs of less than a marketable parcel of shares in a listed company);
- employee share buy-backs that do not exceed the 10/12 limit (see below);
- employee share buy-backs that exceed the 10/12 limit (see below);
- on-market buy-backs that do not exceed the 10/12 limit (see below);
- on-market buy-backs that exceed the 10/12 limit (see below);
- equal access schemes (in which the company offers to buy back the same percentage of ordinary shares from every shareholder) that do not exceed the 10/12 limit (see below);
- equal access schemes (in which the company offers to buy back the same percentage of ordinary shares from every shareholder) that exceed the 10/12 limit (see below);
- selective buy-backs (in which the company buys back shares from only some shareholders).

Each type of buy-back has its own rules. However, one rule is common to all buy-backs that exceed the “10/12 limit”. A buy-back will exceed the 10/12 limit if it would result in the company’s having bought back more than 10% of its own voting shares in the last 12 months: sec 257B(5). Any employee, on-market or equal access buy-back in this category must first be approved by a resolution passed at a general meeting of the company: sec 257C.

The procedural steps to be followed differ depending upon the type of buy-back under consideration. Section 257B of the Law contains a deceptively simple-looking table that details the steps. However, the actual steps, which are detailed in sec 257C-257H, are considerably more complex than would appear from the table. In brief:

- ASIC must be notified before the buy-back;
- the shares bought back are automatically cancelled;

- ASIC is given details of the shares which were bought back and cancelled.

A *selective buy-back* (whether over or under the 10/12 limit) differs from all other types of buy-back in that it must be approved by either:

- a special resolution (which neither the person whose shares are being bought nor that person's associates may vote for); or
- a unanimous resolution agreed to by all ordinary shareholders at a general meeting (sec 257D).

¶13-480 Debentures. Borrowing by a company is another means of company financing, for example, with a debenture. A debenture is “a chose in action [¶13-040] that includes an undertaking by the body to repay as a debt money deposited with or lent to the body” (sec 9). The debenture may be secured by a charge over the property of the company (¶13-048).

Debenture holders are creditors (suppliers of loan capital) rather than members or owners of the company (such as shareholders — suppliers of equity capital). Two main results flow from this difference:

- On winding up, the holders of equity capital (the shareholders) are entitled to a slice of the distributable cake, assuming the company has an excess of assets over liabilities. In contrast, the holders of loan capital are entitled to repayment of their loans, and such repayment precedes any distribution to shareholders.
- Loans to a company usually carry a set rate of interest, which does not vary with the company's profit or loss, whereas the “interest” payable to shareholders (the dividend) is dependent on the company's profits, and rises and falls with profitability.

Debenture with a charge. If the debenture is secured with a charge over the assets or property of the company, the charge may be a fixed charge, a floating charge or a combination of both (¶13-048).

The debenture default clause. The debenture will usually provide that in the event of default by the borrower the whole of the principal and interest will become immediately due and payable. This will enable the debenture holder to sue for the principal and interest, to apply to wind up the company or to appoint (or to apply to the court for the appointment of) a receiver (¶13-553—¶13-557). The events which make the principal moneys immediately repayable revolve around the company's economic viability and may include the following:

- (1) default by the borrowing company in the payment of principal or interest in respect of the debenture deed;
- (2) default in meeting negotiable instruments;
- (3) judgment against the borrowing company remaining unsatisfied;
- (4) the levying of any distress or execution against any of the assets of the

borrowing company, or of the guarantors, for a sum exceeding a specified figure;

- (5) the appointment of a receiver over the property of the borrowing company or any of its guarantors;
- (6) the borrowing company becoming insolvent, or ceasing or threatening to cease the carrying on of business;
- (7) the breach of any covenant in the debenture.

Further consequences of a default clause. A default clause may be breached through oversight or a mere technicality, but the effect of such breach may be far from technical and could involve the automatic crystallisation or fixing of the floating charge with the following perhaps unforeseen and unwanted consequences:

- Because the charge has become crystallised, there may need to be a discharge of mortgage and a re-executing of documents to re-create the floating charge.
- During this period, assets formerly subject to the floating charge may not be able to be dealt with by the borrower freely in the ordinary course of the company's business.

Bonds. One class of debenture or document evidencing or acknowledging indebtedness (secured or unsecured) is a bond — a fixed interest instrument of debt issued by borrowers such as governments, public authorities and companies. Bonds are included in the Corporations Law sec 9 as a “debenture”, and bonds are regulated as “securities” under the Corporations Law sec 92. Bonds may be domestic bonds or international bonds (Eurobonds or foreign bonds).

Junk bonds. The American expression “junk bonds” is not in use in Australia. “Junk bonds” are high yield and speculative bonds with a significant default rate. They can be contrasted with blue chip top-rated corporate and US Treasury issues. “Junk” therefore refers to the investment-grade rating. The issue of junk bonds has helped to finance emerging companies and also takeovers, leveraged buy-outs and buy-backs (in Australia, buy-backs: ¶13-440—¶13-460).

¶13-540 Registration of company charges. Charges over company property must be registered under Corporations Law sec 262.³⁵

35. For the purposes of the Corporations Law, “charge” includes a mortgage and an agreement to give a charge or a mortgage: ¶13-048. However, there are still pitfalls awaiting lenders, purchasers, unsecured creditors, execution creditors and other persons relying on the

Australian Register of Company Charges established under Chapter 2K of the Corporations Law, because various unregistrable transactions will not appear on the Register and may defeat a subsequent security.

The purpose of registration of company charges is to provide information to potential creditors who may consider securing a debt over the assets of the borrower. It also provides information to company members.

Registration of company charges provides conclusive evidence of the matters stated (sec 272).

Within 45 days of the creation of the charge, a notice containing the prescribed details must be lodged with ASIC for registration on the Australian Register of Company Charges (sec 263-265). The charge is not invalidated if it is not registered (sec 262(11)). However, failure to register is an offence under sec 270.

More practically, failure to register a company charge within the 45-day period can lead to postponement of priority to repayment:

- between holders of registrable charges over the same property (sec 279-282) — subject to the exceptions in sec 279(2), where holders can vary the order of priorities; and
- as against any liquidator or administrator (sec 266).

These priorities are in line with the general law (¶13-270):

- where there are equal securities, the first in time will prevail; and
- where there are two securities — one registered and one unregistered — the registered security takes priority over the unregistered security.

Registration operates as notice to the world that the charge is created and anyone dealing with the company, even if it is to create a specific charge, does so knowing that a charge exists.³⁶

— *Example* —

- (1) Chargor Ltd borrowed \$50,000 from the Chargee Bank, secured by a floating charge over all its assets. The charge was registered with ASIC under sec 262. There was no negative pledge prohibiting the creation of future charges (¶13-355).
- (2) Chargor Ltd then borrowed \$25,000 from Chargee Finance Ltd, secured by a registered fixed charge over Asset #1.
- (3) Chargor Ltd then borrowed another \$10,000 from Chargee Finance Ltd secured by a registered fixed charge over Assets #1, 2 and 3.

The order of payment is as follows:

The floating charge in Loan (1) takes priority except over a later registered fixed charge: sec 279(3).

36. Many of the charges to be registered under sec 262 must also be registered under State or Territory legislation (ie bills of sale: ¶13-070; ¶13-130; crop liens, wool liens and stock mortgages: ¶13-300). With its national orientation, the

Corporations Law overcomes the need for dual registration of company charges under both the Corporations Law and State/Territory law by providing for registration only under sec 262 (sec 273).

The registered fixed charge in Loan (2) will take priority over the prior floating charge in Loan (1) (sec 279(2), 279(3)). Loan (2) takes priority over Loan (3) as it is first in time (sec 280).

Loan (3). The fixed charge in Loan (3) will not defeat the prior registered fixed charge under Loan (2) over Asset #1.

The fixed charge in Loan (3) will take priority over the registered floating charge in Loan (1) (sec 279(3)).

¶13-550 Managed investment schemes. In addition to the regulation of specific areas of company finance already considered in this chapter (the stock market ¶13-400—¶13-420; share issues ¶13-430—¶13-460; charges and debentures ¶13-480—¶13-540), the Corporations Law also provides regulation of any company profit-making scheme of the very widest scope under the heading of “managed investment schemes” (Chapter 5C, sec 601EA–601QB).

A managed investment scheme is a scheme where an investor purchases an interest from a professional manager who manages the funds to produce a return (sec 9). Managed investments include investment products and services such as property, equities and cash management trusts, ostrich farms and pine plantations.³⁷

If a scheme is a managed investment, Chapter 5C provides that:

- it must be managed by a single “responsible entity” — the company named in ASIC’s records. Managed investment schemes are to be registered with ASIC, their compliance plan is to be lodged with ASIC (sec 601EA) and the responsible entity is to be licensed by ASIC. The responsible entity is responsible for the scheme and its investment decision-making.
- the manager is under a duty to ensure that scheme property is clearly identified as such, and that scheme property is held separately from property of the responsible entity or of another scheme. The scheme must have a compliance plan to ensure this.
- the manager has clear statutory duties to investors, holds scheme property as a trustee for scheme members, and is under trust law duties to the members in relation to its oversight of the scheme property (sec 601FC, 601FD: compare ¶9-880).

This law is administered by ASIC. The various remedies and prohibitions in the Corporations Law apply to managed investment schemes, such as penalties, injunctions and court orders (eg sec 1324).

37. The superannuation segment of the managed funds industry, and products provided by superannuation funds and

approved deposit funds, are regulated by superannuation laws not the managed investments laws.

This law replaced the “prescribed interest” laws with their two-tier structure of a manager and a trustee on 1 July 1998.

¶13-553 External administration of companies under the Corporations Law. External administration of a company under the Corporations Law means that the company:

- has a receiver or another controller appointed to it,
- is under voluntary administration (¶9-620),
- has executed a deed of arrangement or a compromise or arrangement, or
- is being wound up (¶9-600).³⁸

For each different type of external administration, there is a different type of administrator:

Controller. Four types of separate role come under the term “controller”:

(1) *receiver*. A receiver is a person who enters into possession of the property of a person or a company in accordance with the powers in a particular document (such as a charge over the company’s property). A receiver collects and receives moneys and holds and secures property on behalf of those entitled to it in cases such as those involving minors, estates pending probate, or administration, partnership disputes, and, in the present context, to protect the interests of a creditor.

As an alternative to appointing a receiver, a secured creditor may elect:

- to assume possession of the property of the company for the purpose of enforcing the creditor’s security (and thereby become a “mortgagee in possession”); or
- to appoint an agent to enter into possession and take control of such property, for the purpose of enforcing the security of the creditor (“an agent of the mortgagee in possession”).

Although some receivers are appointed by the court as a “company caretaker” (if there is no, or inadequate, power of appointment in the security document), most are appointed out of court to act as a “company doctor”.³⁹ Appointment may be made in the following circumstances:

- (a) where a loan (whether secured or unsecured)⁴⁰ has become immediately payable by the company to the lender (under a debenture, mortgage,

38. Based on Australian Securities Commission, *External Administration*, June 1995.

39. *Duffy v Super Centre Development Corporation Ltd* [1967] 1 NSWLR 382, per Street J at p 384.

40. The *Bond* case confirmed that an unsecured creditor cannot normally

appoint a receiver unless the company’s assets are at risk: *Bond Brewing Holdings Ltd v National Australia Bank Ltd* (1990) 8 ACLC 330, noted eg Charter, Vol 61, No 7, p 26 (August 1990); (1990) 104 The Australian Banker 214.

- charge, trust deed, etc), or where interest is in arrears, or where the company has otherwise defaulted (for example, by breaching a term of a debenture (§13-480));
- (b) where a winding up order has been made by the court or a winding up resolution has been passed (§9-600—§9-620), and where a debenture holder, for example, wishes to realise its security independently of the winding up;
 - (c) where a minority shareholder who is bringing legal action against the majority shareholders (§9-470) fears that the company assets may be dissipated pending the outcome of the action;
 - (d) where assets of the business are proposed to be sold other than in the ordinary course of business and the business has ceased to be a going concern;
 - (e) where assets of a partnership, trust or an estate require protection from dissipation;
 - (f) where a security is in jeopardy.

Whereas a receiver is appointed (as discussed above), a mortgagee enforces its rights under the security by entering into possession or taking control of company property, the subject of the mortgagee's security. A mortgagee commonly takes control in the circumstances referred to in (a) above. The mortgagee, may, however, elect to appoint an agent to enter into possession of the property.

The powers and responsibilities of a receiver do not apply to a controller who is not formally appointed as a receiver.

- (2) *receiver and manager*: sec 90. A receiver and manager has the powers of a receiver, but they extend to managing the affairs of the company;⁴¹
- (3) *controller (other than a receiver)*: sec 9. A controller is a person who has not been appointed as a receiver, but who enters into possession or assumes control of a company's property for the purposes of enforcing a charge. This person may be the chargee, or a person appointed by the chargee as set out in the instrument;
- (4) *managing controller (other than a receiver and manager)*: sec 9. This person is a controller — not a receiver — and has a management role.

41. For the purposes of the Corporations Law, a reference to "a receiver" should be read as a reference to a receiver and manager (unless the contrary intention appears: Corporations Law sec 416). As to the distinction between a receiver and a receiver and manager, however, sec 90 provides that a receiver is also a manager if that person manages, or is empowered

to manage, the affairs of the company. Accordingly, a *receiver* is a person who receives rents and other income, and pays ascertained outgoings. Unless also a *manager*, a receiver cannot manage the property of the company in the sense of buying, selling or carrying on the business. Riordan, G, *Quizzing corporations laws* (1994) 68 LIJ 611.

Administrator (voluntary administration). This person can be voluntarily appointed by a company which is insolvent, or is likely to become insolvent, so that the company may have a chance to trade out of its difficulties: ¶9-620.

Scheme administrator (arrangements and reconstructions). A scheme of arrangement is a binding agreement between a company and its creditors or members, or, if the company is being wound up, its liquidator and contributors. The agreement must be approved by the court. Section 411(7) sets restrictions on who can be appointed to administer the scheme of arrangement.

Liquidator (liquidation or winding up): See ¶9-625.

¶13-555 Powers of receivers and other controllers. The extent of the powers of a receiver or receiver/manager will depend upon the terms of the court order (in the case of a court-appointed receiver) or the provisions of the document, such as a debenture, under which the receiver was appointed (in the case of a privately appointed receiver). Although the Corporations Law does not set out a code of receivers' powers, it does confirm that a receiver (ie receiver/manager: see ¶13-553n) has power to do "all things necessary or convenient to be done for or in connection with, or as incidental to, the attainment of the objectives" for which the receiver was appointed (sec 420). Section 420(2) sets out powers additional to those in the court order or document of appointment (debentures, etc) in numbered paragraphs (comparable to those of a trustee: ¶9-905) such as the powers to lease, borrow, insure, repair, carry on business, execute any document, etc.

The Corporations Law does not contain a provision equivalent to sec 420 to outline the powers of other types of controllers such as a mortgagee in possession. Instead, in the case of a mortgagee in possession, the extent of the mortgagee's powers depends upon the terms of the security document under which the mortgagee exercised its rights to take possession of company property or to appoint an agent to do so.

¶13-556 Duties of receivers and other controllers. A privately appointed receiver/manager is an officer of the company under sec 9, 82A of the Corporations Law ("officer"), while a mortgagee in possession or its agent is not. A court-appointed receiver is an officer of the court. The primary duty of the receiver appointed by a creditor is to follow the terms of appointment such as to take possession of the charged property and to realise it. The court-appointed receiver's duties depend upon the purpose of appointment. Even though a privately appointed receiver and manager is an "officer" of the company under sec 82A, the receiver and manager still acts primarily for the creditor who appointed the receiver and manager and not for the company, its members or other creditors.⁴² As a fiduciary (¶9-770), the receiver is bound to exercise rights and powers in good faith for the

42. *Re Excel Finance Corporation (Receiver and Manager Appointed)*; *Worthley v*

Australian Securities Commission (1993) 41 FCR 346 at p 363.

person for whom the receiver is acting with the absence of personal profit or conflict of interest.

All controllers are bound to comply with the statutory duties imposed by the Corporations Law, such as to keep accounts and to maintain a separate bank account (sec 421); to prepare and lodge accounts (sec 432); to report on the corporation's affairs to the Australian Securities and Investments Commission within two months of becoming controller (sec 421A); to report breaches or offences by company personnel to ASIC (sec 422) and to pay debts according to the priorities set out in sec 433 (compare ¶9-626). At common law, a controller is under a duty to act in good faith, including a duty not to sacrifice the mortgagor's interests recklessly. Section 420A of the Corporations Law confirms that in selling company property, a controller (including a receiver) is under a duty to the company to take all reasonable care to sell the company property for its market value or for the best price reasonably obtainable.⁴³

¶13-557 Liability of controllers. A controller has the following liabilities, although some of the liabilities referred to in the list which follows apply only to those controllers who are receivers:

- (1) To account for money obtained as receiver.
- (2) To be responsible for loss through wilful default or otherwise without the authority of the deed (privately appointed receiver and mortgagee in possession) or the court (court-appointed receiver).
- (3) To comply with statutory duties established under legislation such as the Corporations Law (eg the duty to lodge accounts and make returns: sec 434).
- (4) To fulfil the controller's obligations without misconduct. In the event of misconduct the court may remove the controller under sec 434A.
- (5) Contracts. A controller is not personally liable for pre-appointment contracts (which of course remain in force) unless adopted by the controller. An exception to this general rule is created by sec 419A of the Corporations Law. Under sec 419A a controller is personally liable for rent or hiring fees payable by the company for property used or occupied after an initial seven-day period even if the agreement in respect of which the rent or hiring fees are payable was entered into before the controller became the controller of the property. However, and in general terms, a receiver is personally liable on contracts entered into in the course of receivership unless otherwise provided.

43. An injunction may be issued if the receiver's auction brochure is misleading or deceptive under sec 52 of the *Trade Practices Act 1974* (Cth) with the result that the mortgaged property may sell for less than its true value: *Kinjella Pty Ltd*

v Jay (1996) ATPR ¶41-514; ¶7-280. Compare *Medforth v Blake* [1999] 3 All ER 97, noted (1999) 73 ALJ 874, upholding the duties of the receiver to the mortgagor: ¶13-045.

- (6) Section 419 reinforces proposition (5) by providing that a controller is personally liable for debts “incurred by [the controller] in the course of the receivership, possession or control for services rendered, goods purchased or property hired, leased, used or occupied” notwithstanding any agreement to the contrary.
- (7) Tort. As a principal, a receiver will be liable in tort for his actions or the actions of his employees such as failure to observe provisions of the Corporations Law.
- (8) Set off. Generally debts owing by the company to a creditor before the appointment of a receiver can be set off against debts owed before that date by the same person (ie the creditor) to the company.
- (9) Indemnity. The personal liability which can be incurred by a receiver must be read subject to the right—
 - in the case of a receiver, to be indemnified out of the assets in respect of all liabilities properly incurred, including remuneration and costs;
 - in the case of a receiver/manager, to be indemnified out of the assets in respect of all liabilities properly incurred by the receiver/manager in carrying on the business of the company.

In contrast to a court-appointed receiver, a privately appointed receiver is in a stronger position regarding indemnity because there is a principal from whom to seek indemnity.

BUSINESS FINANCE AND BANKRUPTCY LAW —

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¶13-558 The principles of modern bankruptcy law. People and businesses will get into financial difficulties if their income does not cover their expenditure and they cannot pay their debts.⁴⁴ There may be many reasons for this. A budget may fail due to poor business skills, poor business advice or inadequate capital. The success of a business may be ruined by economic and political changes. A product or investment may fail in the market. Business and consumer debt may not be able to be serviced. There may be unexpected expenses, for example from major repairs or from litigation.

The two main aims of bankruptcy law are to return funds to creditors and to rehabilitate the bankrupt. In achieving these aims, modern bankruptcy law should include the following principles:⁴⁵

- (1) an impartial and efficient administration for distributing the property of debtors amongst their creditors;
- (2) administrative processes in which debtor and creditor can participate with the least possible delay and expense;
- (3) a convenient means of collecting or recovering property of the debtor that can be applied towards the payment of their debts and liabilities;
- (4) protection of the public interest by punishing the fraudulent and by releasing innocent debtors hit by misfortune.

Advantages of bankruptcy to creditors

- impartial and efficient administration;
- greater returns to creditors because the administration of the bankrupt's affairs is in the hands of expert insolvency practitioners;
- discovery and distribution of undeclared assets;
- equal sharing between creditors in the distribution of the bankrupt's property.

Advantages of bankruptcy to the bankrupt

- impartial and efficient administration;
- protection from harassment by creditors, as their claims to payment are converted to rights to lodge a proof of debt — creditors usually deal with the trustee, not the bankrupt;

44. The website of the Insolvency Practitioners Association of Australia allows businesses to assess their risk of insolvency and to recognise the warning signs: www.ipaa.com.au.

45. Compare ALRC, *General Insolvency Inquiry* Report (1988) para 33.

- if the bankrupt is not fraudulent and is co-operative with the processes, the bankrupt's effective relief or release from financial liabilities and obligations, and the chance for a new start.

Although company insolvency and individual bankruptcy seek these same goals, the law retains "bankruptcy" for individuals and "winding up" for companies.

Bankruptcy Legislation Amendment Act 1996 (Cth). Major amendments to the *Bankruptcy Act 1966* (Cth) commenced operation on 16 December 1996.⁴⁶ The principal Act as amended:

- provides for a "one-stop service" for bankrupts and insolvent debtors within the Insolvency and Trustee Service Australia (ITSA) in the Commonwealth Attorney-General's Department. The 1996 amendments were designed to abolish the office of Registrar in Bankruptcy and to distribute its function among the Inspector-General in Bankruptcy, the Official Receivers, trustees in bankruptcy and the Federal Court;
- confers jurisdiction in bankruptcy on the Federal Court of Australia;
- is modernised and more workable in relation to transfers of property before bankruptcy (§13-640—§13-700);
- contains an improved income distribution scheme (§13-630);
- contains a new Part IX for "debt agreements", a new form of simple, no cost alternative to bankruptcy for low income debtors with few assets and small debts (§13-570);
- has a streamlined Part X of the Act, which provides for agreements with creditors as an alternative to bankruptcy (§13-570);
- has improved registration arrangements and listings of duties and powers of trustees; and
- allows for the creation of the National Personal Insolvency Index — an improved national personal insolvency index set up on a proper statutory basis, subject to scrutiny of federal Parliament.

§13-559 Company winding up and bankruptcy of individuals. Company winding up and the bankruptcy of individuals are both based on the same principles. Many of the procedures are similar, but the criteria for determining the financial situation of an individual (the "acts of bankruptcy": §13-590) are less commercially oriented than the company law equivalents in the Corporations Law (sec 461), and bankruptcy legislation provides for the individual's continued existence by prescribing rules concerning property and capacity. The legislation controlling bankruptcy is the *Bankruptcy Act 1966* (Cth).

46. Second Reading Speech, House of Representatives, 26 June 1996; Senate

8 October 1996. See, eg, Editorial (1996) 4 *Insolvency Law Journal* 95.

The definitions of solvency and insolvency in the *Bankruptcy Act* (added in the 1996 amendments) mirror those in the Corporations Law (sec 95A):

Sec 5(2) “A person is ‘**solvent**’ if, and only if, the person is able to pay all the person’s debts, as and when they become due and payable.”

Sec 5(3) “A person who is not solvent is ‘**insolvent**’.”

Company winding up is regulated by the Corporations Law in a manner similar to the *Bankruptcy Act*. Some aspects of company winding up are discussed in the following pages and at ¶9-610—¶9-626.

As individual bankruptcy and company liquidation are governed respectively by these two Acts, government administration and political accountability is split between the Commonwealth Attorney-General (whose powers are delegated to the Inspector-General in Bankruptcy) and the Australian Securities and Investments Commission (¶9-380).

¶13-570 Procedures under the *Bankruptcy Act*. The *Bankruptcy Act* provides for three principal forms of procedure.

(1) *Sequestration*. Under this procedure the bankrupt’s property (with some exceptions: ¶13-710) is vested in either the Official Receiver in Bankruptcy or a trustee appointed for the purpose, who then distributes it, subject to some priorities (sec 109: ¶13-720), proportionately amongst the creditors. After the available property has been distributed, the bankrupt may apply for early discharge after six months from the date of filing of a statement of affairs (sec 149S). The period of bankruptcy is normally three years, but if there is objection to early discharge by the trustee or the Official Receiver under sec 149D, it may be extended up to eight years (¶13-740).

(2) *Arrangements with creditors without sequestration: Part IX (debt agreements)*. Part IX, added in the 1996 amendments, provides for “breathing space” so that small debtors, in debt perhaps due to unemployment or excessive use of credit, can enter a *debt agreement* (sec 185H) to explore opportunities to deal with their debts outside bankruptcy.

A debt agreement under Part IX is available to debtors with gross income of approximately \$36,000 per annum, and with debts and assets of less than the “threshold amount” (initially set at approximately \$52,000).⁴⁷

To commence action under Part IX, the debtor approaches its creditors to put a “proposal” for dealing with the debts (sec 185). The proposal could include payment of less than the full amount of debt, a moratorium on payment, periodic payments out of income or an undertaking to ask for financial advice. After the proposal is agreed to by the creditors, the debtor passes the proposal to the Official Trustee for assessment (sec 185A).

47. Derived from a statutory formula based on the *Social Security Act 1991* (Cth): sec 155C(5).

If the proposal is in order, the Official Trustee calls a meeting of or contacts the affected creditors to get their acceptance. If the creditors approve the proposal — by 75% in value and by a majority in the number of creditors — the proposal becomes a debt agreement (sec 185A-185B). The debt agreement is then recorded on the National Personal Insolvency Index (sec 185F).

The Official Trustee does not fulfil the function of a trustee in bankruptcy under a debt agreement, because, for example, the debt agreement could provide for the debtor to make payment direct to creditors or third parties.

When the Official Trustee has accepted a debt agreement for processing, a creditor cannot sue separately unless:

- the “deadline” for payment arrives (sec 185F(1)(d));
- the proposal is rejected by creditors at a meeting (sec 185F(1)(e)); or
- the proposal lapses (sec 185F(1)(f)).

A debt agreement proposal will lapse if, for example, it is not accepted by the creditors (sec 185G).

When a debt agreement is in force and registered on the National Personal Insolvency Index, a creditor cannot:

- present a creditor’s petition (sec 185K(1)(a));
- proceed with a creditor’s petition that had been presented before the debt agreement was entered in the Index (sec 185K(1)(b)); or
- enforce any legal remedy against the debtor (other than to enforce a debt arising under a maintenance agreement or maintenance order) (sec 185K(1)(c)).

A debt agreement ends when the debtor’s obligations under it are fulfilled (sec 185N), when another proposal is made and accepted by creditors (sec 185P), by court order (sec 185Q) or if the debtor becomes bankrupt (sec 185R).

Benefit of Part IX to creditors. Part IX arrangements encourage practical arrangements with creditors which are likely to result in a better return for creditors.

Benefit of Part IX to debtors. Low income debtors are given “breathing space” to make arrangements to pay their debts. Part IX arrangements:

- postpone legal proceedings for enforcement of debts;
- avoid the stigma of bankruptcy;
- release the debtor from debts which would otherwise have been provable in bankruptcy;
- are cheaper than bankruptcy and Part X arrangements, because the debtor faces no fees or administrative charges.

(3) *Arrangements with creditors without sequestration: Part X.* Part X allows a debtor to make arrangements with creditors outside bankruptcy in order

to avoid going bankrupt. Part X gives the debtor three possibilities, as set out in sec 187:

- (1) a composition — an arrangement by which the creditors of the debtor agree to accept payment of their debts by instalments or agree to accept a lesser amount in full satisfaction. All creditors must be treated equally in a composition. A composition is a release of all provable debts, so one disadvantage is that the creditors might have got more if the debtor had been declared bankrupt. One advantage is that a composition lets the creditors know how much they are to receive.
- (2) a deed of arrangement — a deed between debtor and trustee which provides for some arrangement of the affairs of the debtor with a view to the payment of the debtor's debts in whole or in part (sec 213). This is designed to let the debtor trade out of difficulties. Creditors may be disadvantaged because of the time this may take and the uncertainty whether the arrangement will work.
- (3) a deed of assignment — a deed by which the debtor transfers ("assigns") all divisible property to a trustee for the benefit of the creditors in exchange for immediate release (sec 213). The deed binds all creditors, so that no creditor can present a creditor's petition or sue the debtor (sec 228).

Many of the steps in Part X are acts of bankruptcy under sec 40(1)(i)-(n), as discussed at ¶13-590.

Benefit of Part X to creditors. Part X arrangements give a debtor a chance to trade out of difficulties. Administration under Part X is cheaper than bankruptcy, and it is more flexible for both creditor and debtor. As a result, the debtor may be more co-operative.

Benefit of Part X to debtors. Part X arrangements avoid the stigma, restrictions and liabilities of bankruptcy. Creditors do not have access to after-acquired property, and the debtor is not liable to make income contributions under Part VI Division 4B (¶13-630). Part X gives the debtor a chance to trade out of difficulties.

Procedure under Part X. The debtor prepares a statement of affairs and proposal, and within 10 days signs an authority for a registered trustee, solicitor or the Official Trustee to call a meeting of creditors and to take over control of the debtor's property (sec 188). When the authority is signed, the debtor's property is under the control (but not the ownership) of the trustee (sec 189).

When the debtor's property comes under Part X, it is subject to a statutory charge (¶13-048) where it is charged with the debtor's unsecured debts and any amount by which the debtor's secured debts exceed the value of the property secured (sec 189AB(1)).

Trustee's report. To provide information to creditors, the controlling trustee must prepare a written report which summarises the debtor's affairs, file it with the Official Receiver within 14 days (sec 189A) and prepare a statement about options open to creditors (sec 189B).

Creditors' meeting. Within 35 days of the debtor's signing the authority (42 days if signed in December), the controlling trustee must call a creditors' meeting (sec 194). The debtor must attend the meeting and answer questions (sec 195). By special resolution (a majority in number and at least 75% in value of the creditors however voting on the resolution: sec 5), the creditors may discharge the debtor, require an assignment or arrangement, or accept a composition with the debtor (sec 204).

Supervision of Part X proceedings and the performance of the trustee. On application to the court by the Inspector-General, Part X deeds can be declared void (sec 222). Court procedures are freed by vesting bankruptcy jurisdiction in court Registrars (instead of judges) for many administrative matters.

¶13-580 **Bankruptcy petitions.** Once an act of bankruptcy has been committed, a bankruptcy petition must then be presented to the court.

Involuntary bankruptcy: creditors' petitions. To found a creditor's petition, an act of bankruptcy must have been committed by the debtor within six months before the presentation of the petition (sec 44(1)). Further, the creditor must be owed \$2,000 or more, or join with other creditors so that the aggregate owed is \$2,000 or more. Provided the debtor has at least one of several specified territorial connections with Australia (sec 43), the court may then make a sequestration order against the debtor's estate.

Voluntary bankruptcy: debtors' petitions. A debtor can file either:

- (1) a declaration of intention to present a debtor's petition under sec 54A. If accepted by the Official Receiver, this protects the debtor from creditors during the "stay period" of seven days while the debtor assesses options available, or
- (2) a debtor's petition for bankruptcy (sec 55).

Once the debtor's petition has been accepted by the Official Receiver, the debtor automatically becomes a bankrupt (sec 55(4)).

Debtors petitions are handled by an Official Receiver. The Official Receiver may reject a petition on any one of three grounds: (1) the petition does not comply substantially with the approved form; (2) there is no accompanying statement of affairs; or (3) the statement of affairs is inadequate (sec 55(3)). The Official Receiver must give the debtor sufficient information for the debtor to be convinced that bankruptcy is the only real alternative, given the individual financial circumstances (sec 55(3A), reg 4.11). The Act provides that a debtor's petition is referred to a court if there is a creditor's petition pending against a group of debtors that includes the debtor who has presented the relevant petition (sec 55(3B)).

— Examples —

"*Example 1.* When Anna presents a debtor's petition against herself, there is a creditor's petition pending against Anna and Tim as joint debtors. The Official Receiver must refer the debtor's petition to the court."

*“Example 2. When Peter presents a debtor’s petition against himself, there are two creditor’s petitions pending against him alone. The Official Receiver is not required to refer the debtor’s petition to the Court because Peter does not form a group by himself.”*⁴⁸

The Official Receiver must accept the debtor’s petition unless it rejects it under sec 55(3) (above) or it is directed by the court to reject it (sec 55(4)).

¶13-590 Acts of bankruptcy. To start bankruptcy proceedings, a creditor must be able to establish that the debtor is insolvent. Insolvency to form the basis of a creditor’s petition is established by proof that the debtor has committed an “act of bankruptcy” as set out in the *Bankruptcy Act 1966* (Cth) sec 40 (for companies, Corporations Law sec 459C).

An act of bankruptcy has a double significance:

- (1) As the test of insolvency, there must be an act of bankruptcy before a creditor can present a petition. Conduct indicating inability to pay creditors is insufficient for a petition unless there is a formal act of bankruptcy.
- (2) The commencement of bankruptcy of a person who becomes bankrupt on a creditor’s petition or because of a sequestration order “relates back” to the debtor’s earliest act of bankruptcy in the six-month period before the presentation of the petition. Dealings by creditors and others with the bankrupt may be targeted by the trustee in bankruptcy under the doctrine of relation back (sec 115: ¶13-640).

Section 40 sets out the various acts of bankruptcy upon which a creditor’s petition can be based:

Section 40(1)(a). A debtor commits an act of bankruptcy “if in Australia or elsewhere he or she makes a conveyance or assignment of his or her property for the benefit of his or her creditors generally”. For the purposes of sec 40(1)(a), “conveyance or assignment” means a transfer of property (a legal assignment or alienation, not a declaration of trust (¶9-830—¶9-840) or a promise to assign (¶13-340)). The debtor’s “property” alienated must be the whole or substantially the whole of the property, and the entire interest in the property must be assigned or alienated. “[C]reditors generally” means that all creditors must benefit; if some creditors are excluded, there is no act of bankruptcy under para (a), but there could be one under sec 40(1)(b) or (c).

Section 40(1)(b). A debtor will also commit an act of bankruptcy if in Australia or elsewhere—

- “(i) he or she makes a conveyance, transfer, settlement or other disposition of his or her property or of any part of his or her property;

48. These examples are provided in the *Bankruptcy Act* sec 55(3B) to illustrate that section.

- (ii) he or she creates a charge on his or her property or on any part of his or her property;
- (iii) he or she makes a payment; or
- (iv) he or she incurs an obligation,

that would, if he or she became a bankrupt, be void as against the trustee”.

This subsection creates an act of bankruptcy from activities of the debtor which would be void against a future trustee in bankruptcy, namely undervalued transactions (sec 120: ¶13-670), transfers to defeat creditors (sec 121: ¶13-680) and preferences, priorities or advantages (sec 122: ¶13-690).

Section 40(1)(c). An act of bankruptcy is committed if a debtor, with intent to defeat or delay creditors, departs from or remains out of Australia, departs from the debtor’s dwelling house⁴⁹ or usual place of business, disappears, or “begins to keep house” (becomes inaccessible to creditors, for example by refusing to see callers).

— *Case example* —

In April 1973, Thomas Barton suddenly left Australia and abandoned his Australian businesses and duties without notifying his intentions to the public officers of the many companies of which he was a director. *Stephen J* said in the course of his judgment:

“... the appellant’s position, even at the date of his original departure from Australia in April, cannot be viewed in isolation from what came to be the indebtedness owed by him to the Deputy Commissioner of Taxation. Although it first arose on 23rd July 1973 the notice of assessment, issued on 20th June 1973, was not a default assessment and must have been preceded by the lodging of a return of income by the taxpayer, as is shown by the fact that the amount of the tax notified in the notice of assessment included ‘additional tax for late return’. ... Accordingly the appellant must have known when he left Australia that in the near future he would be assessed to tax in a very substantial sum. ... This awareness of an impending liability is sufficient for the purposes of s 40(1)(c).”

_____ *Barton v DFC of T*⁵⁰ _____

Section 40(1)(d). Under sec 40(1)(d), a debtor commits an act of bankruptcy if:

- “(i) execution has been issued against him or her under process of a court and any of his or her property has, in consequence, either been sold by the sheriff or held by the sheriff for 21 days; or
- (ii) execution has been issued against him or her under process of a court and has been returned unsatisfied”.

For an act of bankruptcy under sec 40(1)(d):

49. eg *Re Andrews; Ex parte Manning* (1966) 8 FLR 56. A resident who leaves the country after being served with a writ will have to rebut the presumption that

the departure was to defeat creditors: *Ex parte Crispin* (1873) LR 8 Ch App 374.

50. (1974) 131 CLR 370 at p 373-374.

- (1) goods of the debtor must have been seized and sold by the sheriff/court bailiff (§11-435);
- (2) goods must have been seized and held by the sheriff for 21 days without being bought out by the debtor (§11-435); or
- (3) the execution under court process must have been returned unsatisfied (this means that there are no effects to be seized: it does not mean that the debtor cannot be found).

Section 40(1)(da). This provides that a debtor's presentation to the Official Receiver of a declaration of intention to present a debtor's petition under sec 54A constitutes an act of bankruptcy. These sections provide a "cooling-off" period of seven days for counselling and consideration of alternatives to bankruptcy, information concerning which is provided by the Official Receiver (sec 54D, reg 4.11).

Section 40(1)(e). Two distinct acts of bankruptcy are provided for in sec 40(1)(e):

- (1) after having consented at a meeting of his creditors to present a debtor's petition (and thus become bankrupt upon that petition), failing to do so within seven days of the meeting;
- (2) after having consented at a meeting of his creditors to sign an authority under sec 188 and have his estate administered under Part X of the Act, failing to do so within seven days of the meeting.

Section 40(1)(f). Alternatively, sec 40(1)(f) provides that an act of bankruptcy is committed by a debtor who, at a meeting of creditors, *admits his insolvency*, is requested by the creditors to bring his affairs under the provisions of the Act, and who fails to present a debtor's petition or sign a sec 188 authority within seven days of the meeting.

Sections 40(1)(e) and (f) therefore provide two means by which a debtor can bring his affairs under the provisions of the *Bankruptcy Act 1966* (Cth).

Section 40(1)(g): bankruptcy notice. (Corporations Law Part 5.4 (Winding up in insolvency).) A creditor can try to force a debtor to pay by debt recovery process (§11-435) and may try to force payment by the use of a bankruptcy notice: bankruptcy notices are widely used in the debt-collecting process, and failure to comply with them accounts for most bankruptcies. A bankruptcy notice is a statutory demand by a creditor issued by the Official Receiver (sec 41) for repayment on the basis of an existing judgment or a final court order which the creditor has already obtained. Failure to pay under the bankruptcy notice, or failure to satisfy the court of the existence of a "counterclaim, set-off or cross demand equal to or exceeding the amount of the judgment debt or sum payable under the final order" by way of defence, is committing an act of bankruptcy.

Section 40(1)(g) raises a number of issues:

- A "final judgment" is one that finally determines the rights of the parties. If the order has been stayed, it is not available as the basis for a bankruptcy notice (sec 41(3)(b)).

- The bankruptcy notice must be served on the debtor personally, normally within six months of its date of issue.
- Section 306 provides that bankruptcy proceedings are not invalidated by a formal defect or an irregularity (unless substantial and irremediable injustice has been caused).
- A bankruptcy notice overstating the amount due is not invalid if not disputed by the debtor (sec 41(5)). The debtor can comply with an overstated notice by paying or compounding the correct amount within the time period specified (sec 41(6)).
- By way of defence, the debtor may allege a “counter-claim, set-off or cross-demand” equal to or exceeding the creditor’s notice. A “counter-claim” is a claim which one party (defendant; debtor) has against the other (plaintiff; creditor) which is presented as an answer to the other’s claim so that a court can decide both claims in the same action. The claim must be presently existing and measurable in money’s worth, and is not just a claim that may be available in the future. A “set-off” is a cross-claim for a liquidated amount (ie money) by the defendant in the plaintiff’s action to recover money. A “cross-demand” or a cross-action is a claim by the defendant against the plaintiff in a separate and independent action, arising from the same facts as the plaintiff’s action.

A court also has a general power to set aside a bankruptcy notice for such matters as irregularity or defect (sec 30(1)) and to extend the time for compliance,⁵¹ and a court has the power to go behind an original judgment or order if there is evidence that no debt in fact exists.⁵²

Section 40(1)(b). Notice (including that given orally, or indirectly through an agent) by a debtor to creditors that payment of debts has been suspended, or is about to be suspended (even temporarily), if it is an unequivocal admission of inability to pay debts due to insolvency, is an act of bankruptcy under sec 40(1)(b).

Section 40(1)(ha)-(hd). These acts of bankruptcy, added in the 1996 amendments, provide that a debtor commits an act of bankruptcy by entering a Part IX debt agreement (¶13-570) as follows:

- a debtor giving the Official Trustee a debt agreement is an act of bankruptcy under sec 40(1)(ha);
- the acceptance by a debtor’s creditors of a debt agreement proposal given by the debtor to the Official Trustee is an act of bankruptcy under sec 40(1)(hb);
- breach of a debt agreement by a debtor is an act of bankruptcy under sec 40(1)(hc); and

51. *Re Halstead; Ex parte Westpac Banking Corporation* (No 2) (1991) 32 FCR 394, noted (1992) 66 ALJ 381.

52. *Wren v Mahoney* (1972) 126 CLR 212.

- termination of a debt agreement by the debtor is an act of bankruptcy under sec 40(1)(hd).

Sections 40(1)(i)-40(1)(n). These subsections refer to arrangements under Part X of the Act. Their effect is that the debtor cannot initiate any action under Part X without necessarily committing an act of bankruptcy. The first step the debtor must take to bring the Part into operation is to sign an authority under sec 188 for a meeting of creditors to be called. The debtor thus commits an act of bankruptcy under sec 40(1)(i), and the calling of the meeting is another act of bankruptcy (sec 40(1)(j)).

Failing to attend the meeting is an act of bankruptcy under sec 40(1)(k). If the debtor fails to execute a deed of assignment or a deed of arrangement or to present a debtor's petition as required by a special resolution of a meeting of creditors, the debtor commits an act of bankruptcy under sec 40(1)(l). An act of bankruptcy is committed if a Part X arrangement is declared void or set aside by the court (sec 40(1)(m)) or is annulled by the court (sec 40(1)(n)).

The debtor must therefore be prepared to accept that the creditors may petition for the debtor's bankruptcy if the debtor is unable to persuade them to accept an arrangement, assignment or composition under Part X (¶13-570).

¶13-600 Effects of bankruptcy. Although bankruptcy frees a debtor from dealing with creditors (the trustee normally deals with creditors) and allows a debtor to start afresh, it has serious consequences for the bankrupt:

- (1) The bankrupt is divested of virtually all property (see further ¶13-630).
- (2) It is an offence for an undischarged bankrupt to obtain credit or enter other commercial transactions (such as obtaining goods or payment) either alone or jointly with another person to the extent of \$3,000 or more without disclosing that he is an undischarged bankrupt (sec 269(1)(a)-269(1)(ad)).
- (3) It is an offence for an undischarged bankrupt to carry on business under an assumed name or, either alone or in partnership, a firm name, without disclosing his true name and status of bankruptcy (sec 269(1)(b)).
- (4) A bankrupt who is assessed liable to make contributions to the bankrupt estate from his income may not leave Australia, or do any act preparatory to leaving Australia, without the permission of the court (sec 139ZU, 272(c)).
- (5) With certain exceptions, property acquired by the bankrupt before discharge is property divisible among the creditors (sec 116; ¶13-630).
- (6) Any partnership of which the bankrupt is a member is automatically dissolved by the bankruptcy, unless the partnership agreement provides otherwise (¶10-520).

- (7) The bankrupt may not be a director of a company,¹ a member of a local authority, a member of the House of Representatives or of the Senate,² or a member of the State/Territory Houses of Parliament.
- (8) Any civil action commenced by a person who subsequently becomes a bankrupt is stayed until the trustee elects in writing to prosecute or discontinue the action (sec 60(2)). The debtor's right to appeal to a higher court passes to the trustee on bankruptcy. Certain rights of action do not pass to the trustee, such as those which are personal to the bankrupt and which do not affect the size of the bankrupt estate such as actions in respect of:
 - (a) personal injuries or wrongs done to the bankrupt, spouse or family, or
 - (b) the death of the bankrupt's spouse or family members.

If there are any concerns about the administration of the bankrupt estate, "the bankrupt, a creditor or any other person ... affected by any act, omission or decision of the trustee ... may apply to the Court" for a court order (sec 178).

¶13-610 Proof of debts: sec 82. An equitable distribution of the debtor's property among creditors is one of the principal aims of bankruptcy law. Upon sequestration the creditors' rights are converted into the right to participate by proof of debt in the distribution of the bankrupt's estate. Section 82(1) provides that:

"... all debts and liabilities,^[3] present or future, certain or contingent, to which a bankrupt was subject at the date of the bankruptcy, or to which he or she may become subject before his or her discharge by reason of an obligation incurred before the date of the bankruptcy, are provable in his or her bankruptcy."

However, there are limited categories of liabilities which are not provable, which include:

- maintenance agreements or maintenance orders (sec 82(1A));
- unliquidated damages arising otherwise than by reason of a contract, promise or breach of trust (sec 82(2));
- penalties or fines imposed by a court in respect of an offence against a law (sec 82(3)), although pecuniary penalties payable under a civil penalty order are provable (sec 82(3A));
- an amount payable under a pecuniary penalty order made under sec 1317E, 1317G of the Corporations Law (sec 82(3AA));

1. Corporations Law sec 206B; eg *Re Ansett* (1991) 9 ACLC 277.

2. Constitution sec 44(iii).

3. "liability" is widely defined in sec 82(8), with the exception of demands for

unliquidated damages arising in tort: sec 82(2). Debts and liabilities include maintenance agreements under the *Family Law Act 1975* (Cth) sec 82(1A).

- interest accruing after the date of the bankruptcy on a debt provable in the bankruptcy (sec 82(3B));
- debts or liabilities the value of which cannot be fairly estimated by the court (sec 82(4));
- trade discounts for which an allowance would have been made, had the debtor not become bankrupt (but not cash discounts) (sec 87).

Creditors of the bankrupt holding an existing security over the debtor's property for a debt (such as a mortgage or lien: ¶13-040; ¶13-230) have three options under sec 90 of the Act:

- to realise the security and prove for the balance;
- to give up the security to the trustee and prove for the full amount of the debt; or
- to value the security and prove for the balance due after deducting that value (sec 44(2)).

Alternatively, the secured creditor can avoid any of these three options, remain outside the bankruptcy and realise or deal with the security independently (sec 58(5)) according to the appropriate securities law set out, for example, in real property or bills of sale law.

The trustee must examine each proof of debt and may admit the debt in whole, or admit it in part and reject it in part, or reject it in whole, or require further evidence in support of it (sec 102(1)).

Where a creditor, or the bankrupt, considers that a proof of debt has been wrongly admitted, either may apply to the court for an order that the proof be expunged or that the amount of the admitted debt be reduced, and the court may make an order accordingly (sec 99(1)).

Bankruptcy law has always made provision for certain debts to be paid in priority to others. These priorities are set out in sec 109 and reg 6.01(1) (¶13-720; cf ¶9-626).

¶13-620 Mutual credit and set-off: sec 86. Any person owing money to a bankrupt can offset any amount owing by the bankrupt, as sec 86 provides that mutual debits and credits between bankrupt and creditor are to be balanced:

“86(1) Subject to this section, where there have been mutual credits, mutual debts or other mutual dealings between a person who has become a bankrupt and a person claiming to prove a debt in the bankruptcy:

- (a) an account shall be taken of what is due from the one party to the other in respect of those mutual dealings;
- (b) the sum due from the one party shall be set off against any sum due from the other party; and
- (c) only the balance of the account may be claimed in the bankruptcy, or is payable to the trustee in the bankruptcy, as the case may be.”

“[M]utual dealings” giving rise to set-off is a non-technical expression which includes commercial negotiations and transactions. Hence claims include amounts arising in contract, statutory debts (amounts owing to government departments) and the claim of a mortgagee.⁴

The claims must be or must become provable in the course of the bankruptcy.

Further, a person is not entitled to the benefit of set-off under sec 86 if:

- at the time of giving credit to or receiving credit from the bankrupt, the person had notice of an available act of bankruptcy (available for a petition, as defined in sec 5) (sec 86(2));
- the dealings are not mutual (referring to mutuality of parties and mutuality of intentions).

For companies, the equivalent section is Corporations Law sec 553C.

¶13-630 Property available for payment of debts: sec 116.

When a debtor becomes a bankrupt, the property of the bankrupt vests in the trustee (sec 58) — in equity (¶13-220) — until the necessary requirements for transfer of property have been completed (¶13-430ff) (sec 58(2)). The property vested in the trustee which is available for the payment of debts is defined as “real and personal property of every description” (sec 5).⁵ Property vested in the trustee which is available for the payment of debts is:

- (1) property owned by the bankrupt at the commencement of the bankruptcy (sec 116) under the doctrine of relation back (sec 115: ¶13-640) even if disposed of before the date of bankruptcy; and
- (2) *after-acquired property* — property which is acquired by the bankrupt during the bankruptcy and before discharge (sec 58(6)); and
- (3) property of an “associated entity” (sec 5, including companies, natural persons, partnerships and trusts; sec 77A);

minus exempt property (sec 116(2): ¶13-710).

Property divisible amongst the creditors also includes the following:

- (1) Under sec 116(1)(b), the trustee in bankruptcy may exercise the bankrupt’s power, for example under a will or a discretionary trust deed. Therefore, this property over which the bankrupt has a power of appointment becomes available for distribution to creditors.
- (2) Property vested in the trustee under a sec 139D order (under sec 116(1)(c)) and money paid to the trustee under a sec 139E order (under sec 116(1)(d)) — see insolvency fraud, below.
- (3) Some of the bankrupt’s property may be more of a liability than an

4. *Gye v McIntyre* (1991) 171 CLR 609.

5. “Property” does not include the right of a bankrupt to appeal to a higher court,

and it is certainly not property divisible among creditors under sec 116(1)(b): *Cummings v Claremont Petroleum NL* (1996) 70 ALJR 616.

asset (such as land with onerous covenants, unsaleable property or unprofitable contracts) and sec 133 allows the trustee to sign a written “disclaimer of onerous property”.

- (4) *Income contribution scheme: Part VI, Div 4B.* A portion of the income of the bankrupt derived during bankruptcy which exceeds a “base income threshold amount” is to be paid to the Official Receiver or the trustee. Income is defined widely in sec 139L, 139M and 139N of the *Bankruptcy Act*, and includes the value of gifts, payments of expenses and similar benefits provided for a bankrupt by benefactors, whether or not the bankrupt was employed by or provided services for the benefactor. Under the 1996 amendments, the value of “loans” given to the bankrupt (sec 139L(a)(vi)) is included as “income”.⁶ “Base income threshold amount” is linked to the basic benefit rates of payment under the *Social Security Act 1991*.

- (5) Money and property of the bankrupt can be recovered for the benefit of the bankrupt’s estate (sec 139J), including moneys owing by way of contribution from people other than the bankrupt (sec 139ZK, 139ZL).

Collection of void transactions. Transfers of money or property which are void against the trustee in bankruptcy under sec 120-122 (¶13-670—¶13-700) may be recovered. Under sec 139ZQ, the Official Receiver can issue a notice to the person who received the money or property to require the person to repay. No court order is necessary for the Official Receiver to issue a sec 139ZQ notice. The recipient may challenge the notice in court, and the proceedings may result in a negotiated settlement with the Official Receiver.

The bankrupt’s rights under contracts, bills of sale, mortgages, liens and charges are preserved for the trustee and therefore the creditors. Provisions which are intended to restrict the debtor’s rights in the event of an act of bankruptcy or to give the secured creditor an advantage are declared void under sec 301, 302.

Off-shore information notices. The Official Receiver may trace funds of the bankrupt overseas under sec 81A. The Official Receiver has no jurisdiction overseas, but has been given certain powers of enforcement which may compel compliance with off-shore information notices. The Official Receiver may prevent the admissibility in certain legal proceedings of information that had been requested but not provided (sec 81G).

Insolvency fraud. Division 4A (sec 139A-139H) attacks insolvency fraud by extending the trustee’s powers to investigate the bankrupt’s “associated entities” (those which the bankrupt controls or can influence). On the

6. This was added to overcome the restrictive interpretation placed on “income” in *Bond v Trustee of Property of Bond (a bankrupt)* (1994) 125 ALR 399, which had found the previous definition of “income”

inadequate to enable the value of benefits provided to a bankrupt in a non-employment context to be included as income.

application of the trustee, the court may order the transfer of property of an associated entity to the bankrupt estate (sec 139D). It may also order payment to the bankrupt estate of money representing the value of personal services during the “examinable period” of up to four years before the commencement of the bankruptcy (sec 139E).

¶13-640 The doctrine of relation back: sec 115. The date of the bankruptcy is the date the sequestration order is made (sec 43(2)) or, in the case of a debtor presenting a debtor’s petition, “at the first instant of the day on which the petition is accepted by the Official Receiver” (sec 57A). But bankruptcy does not *commence* on the date of the petition or the sequestration order.

In an attempt to preserve the property of the bankrupt available for distribution to creditors by preventing the debtor from disposing of property before bankruptcy, the commencement of bankruptcy “relates back” to the earliest act of bankruptcy committed by the bankrupt within the six-month period immediately preceding the creditor’s petition or the application for the making of a sequestration order (sec 115(1)).

— *Example: relation back — creditor’s petition* —

1 February:	debtor does not comply with creditor’s bankruptcy notice (sec 40(1)(g)).
1 April:	debtor travels interstate to avoid creditors (sec 40(1)(c)) (¶13-590).
1 May:	debtor returns from interstate.
1 June:	debtor does not comply with creditor’s bankruptcy notice (sec 40(1)(g)).
1 September:	creditor lodges creditor’s petition (sec 44).
7 September:	creditor’s petition served (sec 47).
1 November:	hearing, and sequestration order made against debtor (who becomes a bankrupt) (sec 43, 52).

Date of bankruptcy: date of sequestration order, 1 November.

Date of commencement of bankruptcy: 1 April — the earliest act of bankruptcy within the six months immediately preceding the date of the creditor’s petition, under the doctrine of relation back (sec 115).

— *Case example* —

Statutory “garnishee” notices were issued by the Commissioner of Taxation under sec 218 of the *Income Tax Assessment Act 1936* (Cth), before the bankruptcy of Dr Edelsten, against his debtor — the Health Insurance Commission — to give the Commissioner security over the amount due to the doctor from the HIC. The court held that unless this security pre-dated the relation back period, or was subject to a protective provision of the *Bankruptcy Act*, it would be swept aside by the retrospective operation of

sequestration: any moneys paid to the Commissioner during the relation back period were moneys recoverable by or owing to the trustee.

*Re Edelsten; Donnelly v Edelsten*⁷

In the case of a person who becomes a bankrupt as a result of the acceptance of a debtor's petition, the commencement of bankruptcy is taken to have relation back to — and to have commenced at — the time calculated as follows, as set out in sec 115(2):

Debtor's petition bankruptcy — time to which bankruptcy has relation back and time bankruptcy commences	
<i>Circumstances in which debtor's petition was presented or accepted</i>	<i>Time to which bankruptcy has relation back and time of commencement of bankruptcy</i>
1. Petition accepted by the Official Receiver under a direction of the Court.	Time specified by the Court as the commencement of the bankruptcy.
2. Petition presented when at least one creditor's petition was pending against the petitioning debtor (whether alone, as a member of a partnership or as a joint debtor), and accepted by the Official Receiver without a direction from the Court.	Time of the commission of the earliest act of bankruptcy on which any of the creditor's petitions was based.
3. Petition presented when no creditor's petitions were pending but the debtor had committed at least one act of bankruptcy in the past 6 months, and accepted by the Official Receiver without a direction from the Court.	Time of commission of the earliest act of bankruptcy within the 6 months before the petition was presented.
4. Petition presented when no creditor's petitions were pending and the debtor had not committed any act of bankruptcy in the past 6 months, and accepted by the Official Receiver without a direction from the Court.	Time of presentation of the petition.

¶13-650 Dealings protected from doctrine of relation back. The business implications of the relation back of the title of the trustee in bankruptcy (¶13-640) would be serious if not for some protection of genuine commercial transactions offered by the Act.

7. (1988) 18 FLR 434; 88 ATC 4958.

Protection of certain transfers of property against relation back, etc: sec 123. The following transactions listed in sec 123(1) are protected from the doctrine of relation back:

- (a) a payment by the debtor to creditors;
- (b) a conveyance, transfer or assignment by the debtor for market value;
- (c) a contract, dealing or other transaction by or with the debtor for market value; or
- (d) any transaction to the extent of a present advance made by an existing creditor;

if the transaction:

- (e) took place before the date of bankruptcy;
- (f) occurred without notice of the presentation of the petition against the debtor; and
- (g) was in good faith and in the ordinary course of business.

The burden of proof — that the transfer of property took place before the date of bankruptcy, that the person had no notice at the time of the presentation of the petition, and that the transaction was in good faith and in the ordinary course of business — lies on the party seeking to have its transaction protected against the relation back of the trustee's title.

Protection of certain payments etc to bankrupt: sec 124. Payments of money or delivery of property (including a security or a negotiable instrument) to a bankrupt or a person who becomes a bankrupt (or assignee) during the relation back period would normally vest in the trustee for the benefit of all creditors unless:

- (a) if before bankruptcy, "it is made in good faith and in the ordinary course of business" (sec 124(1)(a)); or
- (b) if after bankruptcy, "it is made in good faith, in the ordinary course of business and without negligence" (sec 124(1)(b)).

¶13-660 Executions and attachments before bankruptcy:

sec 118-119A. Sections 118-119A are designed to prevent an earlier creditor who has issued execution against the property of a debtor (¶1-435), or who has instituted proceedings to attach a debt due or to enforce a charge from gaining an advantage over other creditors, as these sections permit the trustee to recover the proceeds arising "as a result" of those proceedings. The sheriff is to refrain from enforcing a judgment for a creditor (after notice of the petition: sec 119), and is to deliver property of the bankrupt to the trustee (after receiving notice of the bankruptcy: sec 119A). Moneys received "as a result of" execution include sale proceeds from the debtor's property and moneys paid to avoid sale or seizure of property. There is no creditor defence of good faith, acting in the ordinary course of business or absence of knowledge of the insolvency of the debtor, or the commission of an act of bankruptcy.

¶13-660

¶13-670 Undervalued transactions: sec 120. Undervalued transactions are void against the trustee in bankruptcy under sec 120. These “undervalued transactions” are transactions made by a person who later becomes bankrupt if:

- the transfer occurred within *five* years of the commencement of the bankruptcy, and were made for
- no consideration; or
- consideration of less value than the market value of the property (sec 120(1)).

Transactions which are void against the trustee may be recovered under sec 139ZQ: ¶13-630.

The following examples from the earlier sec 120 illustrate the scope of the current sec 120:

— *Case examples* —

A gift without consideration disguised as a contract of sale never intended to have legal effect would be an “undervalued transaction”.

_____ *Trimbole v Donnelly*⁸ —

A bankrupt mortgaged real estate to her two sons in consideration of their forbearance to sue her for money she owed them (this is good consideration to support a contract: ¶5-440). The mortgage was void against the trustee under the former sec 120, and would now be void as an “undervalued transaction” as the consideration was “less value than the market value of the property”.

_____ *Re Pahoff; Ex parte Ogilvie*⁹ —

Section 120(2) provides exceptions in the cases of:

- Commonwealth, State or Territory taxes (sec 120(2)(a));
- transfers under maintenance agreements or maintenance orders (sec 120(2)(b));
- transfers of property under a Part IX debt agreement (sec 120(2)(c): ¶13-570); or
- transfers described in the *Bankruptcy Regulations 1996* (Cth) (sec 120(2)(d)): where the costs of recovering the property would exceed the value of the property (reg 6.09).

Section 120(3) provides that a transfer is not void against the trustee if the transfer took place more than *two* years before the commencement of bankruptcy and the transferee proves that at the time of the transfer the transferor was solvent. For example, if a person transferred property to another person four years before the date of bankruptcy for less than market

8. *Trimbole v Donnelly*, Full Federal Court of Australia, 5 November 1986. 9. (1961) 20 ABC 17.

value, and at the time the transferor was solvent, the transfer would not be void against the trustee.¹⁰

Transfers to relatives, transfers made by deeds to spouses and de facto spouses, transfers made where there is a promise to marry or where love or affection exist have no value as consideration (sec 120(5); the same as sec 121(6)) and would be void against the trustee under sec 120(1).

Transfers of property under Part IX debt agreements (§13-570) are exempt from sec 121 (sec 121(7)).

A person acquiring the property in good faith and for at least the market value is protected from sec 120 (sec 120(6); the same as sec 121(8)).

Transactions which are void against the trustee may be recovered under sec 139ZQ: §13-630.

A parallel section applying to “uncommercial transactions” in the winding up of companies can be found in Corporations Law sec 588FB.

§13-680 Transfers to defeat creditors: sec 121. Transfers of property by a person who later becomes bankrupt are void against the trustee if the bankrupt’s “main purpose” in transferring the property was to defeat creditors by preventing, hindering or delaying the transferred property from being available to creditors (sec 121(1)).

The “main purpose” test of sec 121(1) is satisfied if it can be shown that the transferor was, or was about to become, insolvent at the time of the transfer (sec 121(2)).

A transfer is not void against the trustee if the transferee:

- gave consideration of at least market value, and
- did not know that the transferor’s main purpose was to defeat creditors, and
- could not have inferred that the transferor was, or was about to become, insolvent (sec 121(4)).

The following case under the earlier sec 121 would also fall under the current sec 121:

— *Case examples* —

The “Syren”. An Ipswich publican in financial difficulties abandoned his hotel and presented a debtor’s petition. His mortgagee “took over everything”. Before the mortgagee sale and before he knew his exact financial position, he arranged to sell his boat to his mother and to have her lease it back to him for 10 years at full rent payable in advance. This disposition was held to be fraudulent and void against the trustee in bankruptcy: the bankrupt

10. Minister’s Second Reading Speech, Hansard, House of Representatives, 26 June 1996, p 2828.

did it to retain possession of the boat (on which he lived) and to prevent it from being taken for the benefit of his creditors.

_____ *Re Barnes; Ex parte Stapleton*¹¹ _____

W Pty Ltd was a “shelf company” controlled by D with two issued \$1 shares. D transferred one share in W Pty Ltd to his son, an 18-year-old university student, for \$1 and D’s company transferred the other share in W Pty Ltd to Mrs D for \$1. D’s purpose was to put W Pty Ltd beyond the reach of creditors on the basis that it was to acquire property in which the creditors had no right or interest. The High Court held that this disposition was not a transfer to defeat creditors — the disposition was not at undervalue, and it led to no depletion of the assets available to creditors.

_____ *Cannane v J Cannane Pty Ltd (in liq)*¹² _____

Transfers to relatives, transfers made by deed to spouses and de facto spouses, transfers made where there is a promise to marry or where love or affection exist have no value as consideration (sec 121(6): the same as sec 120(5)) and would be void against the trustee under sec 121(1).

For example, if a person gives property to another for love and affection, even one year before the commencement of their bankruptcy, the transfer will be void against the trustee.¹³

A person acquiring the property from the transferor in good faith and for at least the market value of the property is protected from sec 121 (sec 121(8): the same as sec 120(6)).

Transactions which are void against the trustee may be recovered under sec 139ZQ: ¶13-630.

¶13-690 Avoidance of preferences: sec 122. The *Bankruptcy Act* aims to give equal treatment to all creditors. It invalidates payments and other transactions by a debtor to a creditor in the period before bankruptcy which give the creditor preference over other creditors. Section 122 states that preferences are “void against the trustee” in the bankruptcy of the debtor.

The parallel Corporations Law sec 588FA applying to the winding up of companies was added in 1993.

_____ *Case example* _____

One month before the company went into voluntary liquidation, a management trainee (the 17-year-old son of the director) was paid £2,000 on his dismissal from employment. He paid this into his bank account on his father’s instructions, and then lent £3,000 from the account to a new

11. [1962] Qd R 231; (1961) 19 ABC 126.

12. (1998) 72 ALJR 794. In a strong dissent, Kirby J paid “tribute to the ingenuity of [D’s] arguments” which in his view disguised D’s intent to defeat creditors.

13. Minister’s Second Reading Speech, Hansard, House of Representatives, 26 June 1996, p 2828.

company acquired by his father. The payment was held to be a fraudulent preference under the equivalent of sec 122, and a tracing order was made.

_____ *Re Clasper Group Services Ltd*¹⁴ _____

To prove that a preference exists, the trustee must establish the five elements of sec 122(1).

(1) A “*transfer of property*”. This includes a payment of money and the doing of “something” that results in another person becoming the owner of the property (sec 122(8)). Transactions targeted under sec 122 include a conveyance, a charge on property (such as a mortgage (¶13-040) or bill of sale (¶13-070), a payment made or an obligation incurred by debtor to creditor.

(2) *The debtor must be insolvent*. Under sec 5(2), “a person is solvent if, and only if, the person is able to pay all the person’s debts, as and when they become due and payable”. Under sec 5(3), a person who is not solvent is insolvent. Case law establishes:¹⁵

“(a) The expression covering the ability to pay debts is concerned with the position of the debtor at the time when the charge or payment is made or other specified act takes place. The concern is with the present, but in considering the present position regard may properly be had to the recent past — whether the debtor has in recent weeks been unable to pay debts as they become due.

(b) In determining ability to meet debts as they become due, account must be taken of outstanding debts.

(c) The words ‘as and when they become due and payable’ [in the definition of “insolvent” in sec 5(2)] mean, as they become legally due.

...

(e) If, as is well established, convertibility of non cash assets on hand may be taken into account in determining solvency, so too must debts becoming due while that conversion takes place. Moreover the words ‘as they become due’ involve consideration of a debtor’s position over a period not at an instant of time.

(f) The test of solvency is an objective one.”

(3) *The transaction must be “in favour of a creditor”*. The person or corporation receiving the benefit of the transaction must be a creditor, or more accurately, a past creditor, as it is not a sufficient cause to avoid a transaction if a company continues to carry on business and in doing so acquires goods or services for which it pays.¹⁶

14. [1989] BCLC 143.

16. *Robertson v Grigg* (1932) 47 CLR 257.

15. *Re Universal Management Ltd (in liq)*
(1981) NZCLC ¶95-026, per Davison CJ;
confirmed [1983] NZLR 462.

The Act makes clear that a transfer “in favour of a creditor” includes a transfer to a creditor whether or not:

- the liability of the creditor is the creditor’s separate liability or joint liability (sec 122(1A)(a));
- the property transferred is the debtor’s own property or jointly owned property (sec 122(1A)(b)); or
- the transfer is made in favour of a person in trust for the creditor (sec 122(4)(a)).

(4) *The transaction must have the effect of giving a creditor a preference, priority or advantage over other creditors.* The test of whether preference has been given is an objective one. The effect of the transaction must be to give the creditor “a preference, priority or advantage over other creditors”. Section 122 establishes an objective test and the intent or state of mind of the debtor is not relevant. The state of mind of the *creditor* is, however, of importance. Where the creditor either realised the company was insolvent, or had sufficient knowledge of the company’s circumstances to conclude that the company was insolvent, it will be found to have had sufficient knowledge to realise that the effect of any payments to it would be to give a preference, priority or advantage over the other creditors, and would not be protected by sec 122: ¶13-700.

(5) *The transaction must have taken place in the period set out in the Act.* Section 122(1)(b) provides that transfers may be preferences depending on the type of bankruptcy petition:

Periods during which transfers of property may be void: sec 122(1)(b)	
<i>Description of petition leading to debtor’s bankruptcy</i>	<i>Period during which the transfer was made</i>
1. Creditor’s petition	Period beginning 6 months before the presentation of the petition and ending immediately before the date of the bankruptcy of the debtor.
2. Debtor’s petition presented when at least one creditor’s petition was pending against a petitioning debtor or a member of a partnership against which the debtor’s petition was presented.	Period beginning on the commencement of the debtor’s bankruptcy and ending immediately before the date of the bankruptcy of the debtor.
3. Debtor’s petition presented in any other circumstances.	Period beginning 6 months before the presentation of the petition and ending immediately before the date of the bankruptcy of the debtor.

Recovery of property by Official Receiver. Sections 120, 121 and 122 (see also ¶13-670—¶13-680) set out many classes of transactions which are “void against the trustee”. Until the 1992 “high flyer” amendments, the trustee had

to chase these transactions by court proceedings. The Official Receiver may now recover property disposed of by a bankrupt in a transaction which is void against the trustee by administrative means instead of exclusively by litigation (sec 139ZQ-139ZT) (¶13-630). A charge is created over the property (sec 139ZR: ¶13-048) and failure to comply is an offence (sec 139ZT).¹⁷

¶13-700 Preferences and protected transactions: sec 122(2).

Bona fide transactions between debtor and creditor are protected if the person from whom the trustee seeks to recover is "a purchaser, payee or encumbrancer"¹⁸ whose rights were acquired:

- "in the ordinary course of business"¹⁹ ... in good faith and who gave consideration at least as valuable as the market value of the property" (sec 122(2)(a)). In good faith (bona fide) means honestly, and the possibility of a creditor's claiming good faith is negated if the creditor knew or had reason to suspect that the debtor was insolvent, and that the payment would give the creditor a preference (sec 122(4)(c)). The "market value" of property transferred is the value of the property at the time of the transfer (sec 122(8)(c));
- through or under a creditor of the debtor: the third party protection of sec 122(2)(b)); or
- under a maintenance agreement or maintenance order (sec 122(2)(c)).

— Case examples —

Hennessy's Self Service. Various suppliers with running accounts were paid by an insolvent supermarket. Some of the cheques to reduce the account were dishonoured, but were later paid. When the supermarket finally went into liquidation, its liquidator attempted to recover these payments as preferences. The liquidator was unsuccessful: the dishonour of a cheque suggests temporary lack of liquidity, but it need not suggest insolvency. Therefore the payments were received by the suppliers in good faith and were protected from being preferences by the equivalent of sec 122(2)(a)/122(4)(c).

— Queensland Bacon Pty Ltd v Rees²⁰ —

Compass Airlines. Payments by Compass on a running account over a six-month period to the Civil Aviation Authority (the CAA — now Airservices)

17. As recommended in ALRC, *General Insolvency Inquiry* Report 45, *op cit*, Ch 14 (Avoidance of antecedent transactions).

18. ie everybody except those who receive gifts or settlements, who would in any case not be entitled to protection because of the absence of valuable consideration.

19. In the words of the NSW Court of Appeal, "the addition of the 'ordinary course of business' requirement to the

'good faith' requirement ... has [not] been of any noticeable usefulness in preference law": *Harkness v Partnership Pacific Ltd* (1997) 143 ALR 227, noted (1997) 71 ALJ 352; see further Keay, A, *The "in the ordinary course of business" element in preference law: has it passed its used by date?* (1997) 5 Insolv LJ 41; Aitken, L, *Preferences, pre-payments and professional fees* (1999) 37(3) LSJ 47.

20. (1966) 115 CLR 266.

for navigation, meteorological and rescue services were not preferences: “If the sole purpose of the payment is to discharge an existing debt, the effect of the payment is to give the creditor a preference over other creditors unless the debtor is able to pay all of his or her debts as they fall due. But if the purpose of the payment is to induce the creditor to provide further goods or services as well as to discharge an existing indebtedness, the payment will not be a preference unless the payment exceeds the value of the goods or services acquired.”

In contrast, the last payment demanded by the CAA when it had a strong suspicion that Compass would “fold” the next day (as it did shortly after) was a preference. This was the partial payment of an old debt — the CAA had looked backwards, rather than forwards to the provision of continuing services, and it was not protected by sec 122(2)(a).

*Airservices Australia v Ferrier*²¹—

¶13-705 Voidable transactions: companies. There are separate rules applying to companies to invalidate the following past insolvent transactions and unfair loans:

- unfair preferences (sec 588FA: ¶13-690).
- uncommercial transactions (sec 588FB: ¶13-670).
- insolvent transactions (sec 588FC).
- unfair loans to a company, such as pre-liquidation loans to the company at high interest designed to defeat unsecured creditors (sec 588FD).
- voidable transactions (sec 588FE, 588FF) subject to the defences in sec 588FG.
- floating charges created within six months before the relation back day (sec 588FJ).

¶13-710 Property not available for payment of debts. Limitations on property divisible amongst creditors are defined in sec 116(2), based upon the principles that the bankrupt should be left with the resources necessary to live an “ordinary” lifestyle and that the bankrupt should have the opportunity of financial rehabilitation. These include:

- trust property in which the bankrupt has no beneficial interest (sec 116(2)(a));
- “household property” prescribed by the *Bankruptcy Regulations 1996* (Cth) or identified by a creditors’ resolution (sec 116(2)(b));
- property of the bankrupt used “in earning income by personal exertion” that does not exceed the amount prescribed by the *Bankruptcy Regulations*, identified by a creditors’ resolution or by a court order (sec 116(2)(c));

21. (1996) 70 ALJR 655 at p 665, noted (1997) 71 ALJ 17 (Baxt).

- means of transport used by the bankrupt up to the value set by the *Bankruptcy Regulations* (sec 116(2)(ca)); 116(2)(p);
- policies of life insurance or superannuation as calculated under sec 116(5) (sec 116(2)(d));
- damages or compensation for personal injury or wrong done to the bankrupt, the bankrupt's spouse or a family member, or in respect of the death of the spouse or a family member (sec 116(2)(g));
- amounts paid by a State government under the rural reconstruction scheme (sec 116(2)(k));
- amounts paid by the government of a State or the Northern Territory under the rural adjustment scheme (sec 116(2)(m)—(md));
- property purchased with money exempted under sec 116(2)(n); 116(2)(p).

A transfer of property in satisfaction of claims for professional fees as well as for claims of a non-revenue nature must be carefully apportioned, otherwise the whole amount may be classified as after-acquired property within sec 116 (¶13-630) therefore divisible amongst the creditors.²²

¶13-720 Order of payment of debts: sec 109. The basic principle of bankruptcy law is that the bankrupt's divisible assets (see ¶13-630) are to be applied equally amongst creditors (sec 108). However, some debts receive priority (mainly under other statutes, common law and equity law and sec 109) and are to be paid in full before the ordinary unpreferred debts, while payment of some debts is postponed until all the other creditors have been paid in full. Similar rules apply under the Corporations Law to the winding up of an insolvent company (sec 553E: ¶9-626).

The following order of priority assumes that:

- (1) exempt property has been excluded for the bankrupt's benefit (sec 116(2): ¶13-710);
- (2) secured creditors (such as mortgagees, lienees, assignees of trade debtors) are repaid from their own secured property outside the bankrupt estate;
- (3) set-off creditors have exercised their rights of set-off (sec 86: ¶13-620);
- (4) property not available because of other legislation, eg family law, has been excluded (*Family Law Act 1975* (Cth) sec 78, 79) (the interaction of bankruptcy (claims of creditors) and family law (claims of family) present complications);
- (5) expenses of creditors of necessity have been met (cf sec 109(1)(j));
- (6) property held in trust is excluded;

22. eg *Weissova v Official Trustee in Bankruptcy* (1986) 12 FCR 106; (1986) 66 ALR 479, noted (1987) 61 ALJ 247.

- (7) the court has not made any special order adjusting priority of distribution (sec 109(9));
- (8) proceeds of insurance against third party liabilities are channelled to the insured party (sec 117).

Indemnities. The Act encourages creditors to support the trustee in bankruptcy (or the company liquidator) in its efforts to recover the debtor's property for the benefit of all creditors: a creditor providing an indemnity receives a preferred distribution as an unsecured creditor (in addition to the repayment of expenses under sec 109(10)).

Priority payments: sec 109 and reg 6.01. Claims by creditors are ranked by the *Bankruptcy Act 1966* (Cth)²³ and reg 6.01 and Sch 3 of the *Bankruptcy Regulations* in descending order as follows:

- (1) realisations charges payable under an Act, and fees payable on payment of dividends, etc (reg 6.01(1), Sch 3 item 1);
- (2) expenses incurred by the trustee (or by the trustee's authority) in protecting the assets, carrying on the bankrupt's business in accordance with the Act or by way of an advance made to the trustee for any proper payments (reg 6.01(1), Sch 3 item 2);
- (3) other fees, costs, charges and expenses payable by the trustee in the bankruptcy (reg 6.01(1), Sch 3 item 3);
- (4) repayment of any unused deposit lodged by a petitioning creditor in connection with the appointment of a trustee to control the property or any other court order under sec 50 (reg 6.01(1), Sch 3 item 4);
- (5) the taxed costs of the petitioning creditor, or applicant for sequestration, a person administering the estate of a deceased person or any such costs of a creditor for an application ending, discharging or voiding a debt agreement (reg 6.01(1), Sch 3 item 5);
- (6) the remuneration of the trustee (reg 6.01(1), Sch 3 item 6);
- (7) the fair and reasonable out-of-pocket expenses incurred by a member of the committee of inspection as allowed by the trustee (reg 6.01(1), Sch 3 item 7);
- (8) the costs of any audit carried out under sec 175 (reg 6.01(1), Sch 3 item 8);
- (9) certain deductions under the *Income Tax Assessment Act 1936* (Cth) (sec 221YHJ; 221YHZD; 221YU) and unremitted employer child support deductions under the *Child Support (Registration and Collection) Act 1988* sec 50 (sec 109(1A)(a)-109(1A)(b));
- (10) in the case of a bankrupt who has previously signed an authority under sec 188 (Part X: ¶13-570), the remuneration of the controlling trustee

23. Div 2 of Pt VI, and in particular sec 109, which also contains many exceptions.

and costs, charges and expenses properly and reasonably incurred during the period in which the authority is in force, including any debts incurred by the controlling trustee that are provable in the bankruptcy (sec 109(1)(b));

- (11) where the bankruptcy occurs within two months after a Part X arrangement (¶13-570), or a scheme of arrangement has been declared to be void or has been annulled, set aside or terminated — payment of the liabilities, commitments, expenses or remuneration of a trustee due under those arrangements as set out in sec 114 (sec 109(1)(c));
- (12) if the estate is being administered under deceased debtor provisions (Part XI), funeral and testamentary expenses (sec 109(1)(d));
- (13) amounts due to employees up to \$3,100 (plus CPI from 1 July 1997) per employee in respect of services rendered to and for the bankrupt before the bankruptcy (salaries, wages or commission) (sec 109(1)(e), reg 6.02(2));
- (14) amounts due in respect of compensation payable under any law of the Commonwealth or of a State or Territory relating to workers' compensation where the liability accrued before the date of the bankruptcy (sec 109(1)(f));
- (15) amounts due to or in respect of any employee of the bankrupt for long service leave, extended leave, annual leave, recreational leave or sick leave for the period before the date of bankruptcy (sec 109(1)(g));
- (16) apprentice indenture fees overpaid (sec 113) (sec 109(1)(h));
- (17) preferences, priorities, advantages, costs, charges or expenses that a meeting of creditors, by special resolution, agrees to (sec 109(1)(j));
- (18) ordinary unsecured creditors;
- (19) deferred creditors: (a) claims of persons under contracts, etc void against the trustee (sec 120(4)); (b) claims by entities associated with the bankrupt (sec 139H(1)) where property has been vested in the trustee (sec 139D or 139E: an unsecured claim may be made under sec 139H(2) and 120(4));
- (20) any surplus, after payment of all the above categories, to the bankrupt. Statutory subrogation (compare ¶17-920) is provided to those who have paid employees' wages or leave, which if unpaid would rank in priority. The persons who have paid (often a bank which has earmarked an account "for wages only") may rank for priority repayment (sec 109(2), (3)).²⁴

¶13-730 Possession, realisation and distribution of property: sec 129-147. On bankruptcy, the debtor's property vests in the Official Trustee in Bankruptcy or a registered trustee who is trustee of the estate

24. Based upon Taylor, T, Ferrier, I and Hodgson, T, *CCH Australian Insolvency Management Practice*.

(sec 58). If the creditors appoint a registered trustee, it passes to the trustee (sec 132). The Act empowers the trustee to take possession of, realise, and distribute the property of the bankrupt for the creditors (sec 129, 134, and 135) including selling property, carrying on a business, compromising debts, leasing, and, under sec 133 (see ¶13-630), disclaiming onerous property. Under the rule in *Ex parte James*, the trustee in bankruptcy as an officer of the court must not retain money paid as a mistake of law, must act in an honest and upright manner, and must not take advantage of strict legal rights to enrich the bankrupt's estate unjustly at the expense of an innocent claimant.²⁵ Once all the property has been gathered, and creditors determined, the trustee may make a distribution to creditors (sec 140).

¶13-740 Termination of bankruptcy. The bankrupt is returned to the commercial world upon termination of the bankruptcy (*Bankruptcy Act 1966* (Cth) Part VII):

- Early discharge: Part VII Div 3 provides an administrative discharge system whereby a bankrupt can apply to the trustee (not the court) for early discharge after six months if there are no disqualifying factors such as previous bankruptcy or the giving of false or misleading information about financial affairs. Decisions of the trustee are subject to review by the Inspector-General in Bankruptcy and by the Administrative Appeals Tribunal (sec 149ZM).
- The bankrupt is automatically discharged after three years if there are no objections (provided the bankrupt's affairs have been conducted properly: sec 149) (¶13-570).

The effect of discharge from bankruptcy is to release the bankrupt from all debts (including secured debts) provable in the bankruptcy (sec 153).

Bankruptcy may also be terminated by annulment whereby the bankruptcy is set aside and the bankrupt restored to his original status (sec 74(5), 153A, 153B, 154), for example where the petitioning creditor had no right to petition.²⁶

25. *Ex parte James; re Condon* (1874) LR 9 Ch App 609; applied, eg, *Re Country Stores Pty Ltd* [1987] 2 Qd R 318.

26. Hassall, DA, *Annulment of bankruptcy and review of sequestration orders* (1993) 67 ALJ 761.

Chapter 14

Consumer Credit

CONSUMER CREDIT CONSPECTUS	¶14-010—¶14-067
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CONSUMER CREDIT CONSPECTUS _____

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¶14-010 Consumer credit overview. In a consumer credit transaction a buyer is allowed to purchase goods and services by paying the purchase price over a period of time. The deregulation of Australia's financial markets in the 1980s (¶16-010) has resulted in easily available credit from the fiercely competitive credit providers (such as banks, building societies, finance companies, credit unions).

Consumer credit was traditionally regulated according to the form taken by the credit arrangement, rather than according to its substance, and was governed by many statutory provisions, including hire-purchase (¶13-050; ¶14-060), lay-by, moneylenders and bills of sale (¶13-070—¶13-140) legislation.

¶14-010

With the coming into force of new consumer credit legislation in South Australia (1972), Victoria, New South Wales, Western Australia and the ACT (1985), and Queensland (1989), credit transactions were “modernised” and standardised to the benefit of both lender and borrower (¶14-155). However, this legislation was the product of the 1970s marketplace, and although it did contain reforms, it was still very complex, inflexible and prescriptive.

The desirability of uniform simplified credit laws was indorsed by the Ministerial Council on Consumer Affairs (MCCA) (formerly called the Standing Committee of Consumer Affairs Ministers (SCOCAM)), and in May 1993 agreement was reached on the introduction of the new uniform Australia-wide Consumer Credit Code, which was passed in the Queensland Parliament in September 1994.¹ All States and Territories, except Western Australia, have applied the Queensland Code as local law. The Code is a kind of “co-operative” scheme between the six States and two Territories (like the former Companies Code, the predecessor to the Corporations Law: ¶19-370).

Minor amendments to the Consumer Credit Code were made by the *Consumer Credit (Queensland) Amendment Act 1998* (Qld),² including:

- the removal of sec 15(G)(c) as a “key requirement” (¶14-180) — this required disclosure in the credit contract of the “total amount of credit fees and charges payable”;
- the requirement that an advertisement contain the annual percentage rate only if the advertisement states the “amount of any repayment” (sec 140(3)) (¶14-160);
- providing that an offer can be accepted by the processing of a debit on the debtor’s account if provided for in the contract (sec 12) (¶14-180).

In addition, certain transitional matters from the former legislation which were due to expire on 1 November 1998 were legislated to take effect from that date.

Post Implementation Review recommendations. The Ministerial Council of Consumer Affairs set up a UCCC Post Implementation Review in 1997, which has recommended:

- simplifying pre-contractual information given to consumers before they

1. See generally CCH *Australian Consumer Credit Law Reporter*; Duggan, A and Lanyon, E, *Consumer Credit Law*, Butterworths, 1999; Moore, AP, *Uniform consumer credit legislation — future relevance of solutions to past problems* (1995) 1 Flinders Journal of Law Reform 60; McDougall, R, *An introduction to the Consumer Credit Code* (1996-97) 15 Aust Bar Rev 4.

2. The amendments made by the remaining provisions of the *Consumer Credit (Queensland) Amendment Act* commenced on 28 October 2000: see further www.creditcode.gov.au; Cowman, M, *Credit Code gets an amendment for its birthday* (1999) 15 BLB 8.

borrow (¶14-180), and making it easier for consumers to understand and compare credit products;

- revision and clarification of several current provisions, including recognition of electronic transactions and harmonisation of the Code with the *Electronic Transactions Act 1999* (Cth): ¶5-015;³ and
- maintaining the existing processes for administration of the Code.⁴

The need for reform has been canvassed by a number of commentators. "It is suggested that the substantial reform of the Code, which is urgently required, will only happen if the Corporations Law process is followed: it should be handed over to one (Federal) Minister responsible to one (Federal) Parliament responsible to all Australian people affected by the Code".⁵

¶14-020 Truth in lending: the objectives of modern consumer credit law.

The basic purpose of modern consumer credit law is to streamline the pre-existing laws by replacing the various legal structures covering consumer credit (¶14-030) with one consistent method to deal with credit transactions according to their substance and not their form.

Consumer credit laws protect consumers by applying the principle of truth in lending, fair trading and consumer protection laws to all credit provided for consumer purposes and all consumer lending (which is about 51% of all lending).

Consumer credit laws protect lenders by clarifying their rights and responsibilities (¶14-155).

The Consumer Credit Code does not apply to commercial lending such as commercial hire-purchase (¶14-060—¶14-065), bill discount facilities (¶16-560—¶16-580), certain insurance contracts providing for payment of premiums by instalment (even if for private purposes) and common law lending.

The Consumer Credit Code includes the following:

- full, pre-contractual disclosure to borrowers and guarantors of financial details of the credit contracts (including interest rate and commissions) so that they can make an informed decision (¶14-160—¶14-180). "The ultimate theory behind the philosophy of truth in lending ... is that

3. Until the *Electronic Transactions Act 1999* (Cth) is adopted in each jurisdiction or the Consumer Credit Code is amended, many provisions require consumer credit contracts (¶14-180), notice of variation (¶14-230), etc to be in writing or signed.

4. The Consumer Credit Code Post Implementation Review Issues Paper and the Post Implementation Review Final Report are available on the National Consumer Credit Code Site at www.creditcode.gov.au. The accompany-

ing research report, *Taking Credit: A survey of consumer behaviour in the Australian consumer credit market*, is available at www.justice.tas.gov.au/ca/review.htm. The second round of the review process — the National Competition Policy review — invited submissions by 31 March 2000. Progress of the review can be monitored through www.creditcode.gov.au.

5. Wilkin, J, *Need for reform of the Consumer Credit Code* (1998) 14 BLB 17.

disclosure ... will help to ensure honesty and integrity in the relationship (where one party is normally disadvantaged or even vulnerable); promote informed choices by consumers; and allow the market for financial services to operate effectively.”⁶

- provision of regular statements and notices so that borrowers are advised of the progress of their accounts and any changes in the terms and conditions, including changes in the interest rate (§14-180);
- power to negotiate a variation of contracts to the value of \$125,000 if the borrower is in temporary hardship (§14-230);
- power for a court or tribunal to reopen unjust contracts and scrutinise unconscionable interest rate variations or establishment fees (§14-240);
- protection against unfair contract enforcement and repossession practices (§14-250—§14-260);
- provision for parties to credit contracts, guarantors and the Government Consumer Agency to apply to a court for an order requiring the credit provider to pay an amount as a civil penalty if the credit provider fails to make proper disclosure of the important financial details of the contract (called “key requirements”) (§14-180; §14-280—§14-290).

Criticisms of the Consumer Credit Code include:

- consumers still have difficulty in comparing the cost of credit (§14-170) and there is still no “truth in lending”;
- the timing of point of sale disclosure is too late, as consumers have already decided to buy before they are given the statutory disclosures;
- as so much detail is required to be disclosed, consumers do not comprehend it (§14-180).

§14-030 Legal forms for consumer credit before passing of consumer credit law. The Molomby Committee (§14-070) listed 11 different forms of consumer credit available to the consumer, before the enactment of consumer credit law in the 1980s, for the purchase of an everyday item such as a washing machine or refrigerator. All achieved much the same result, namely the providing of credit for a consumer transaction. Yet each led to quite different legal consequences. These forms of consumer credit continue, but if any fits the definition of a “credit contract”, it is now regulated by the Consumer Credit Code (§14-150).

These 11 forms are:

(1) An instalment (or credit) sale under which ownership of the goods passes to the consumer on the making of the contract. The purchase price plus terms charges are to be paid by instalments.

- The supplier has no enforceable security in the case of default.
- The consumer does not have the benefit of the implied conditions on

6. *Canham v Australian Guarantee Corporation Ltd* (1993) 31 NSWLR 246

at p 254; (1993) ASC §56-227, per Kirby P at p 58,354.

merchantability, etc provided under the uniform hire-purchase legislation; but the consumer may be protected under the *Trade Practices Act* and State/Territory consumer protection law.

- The transaction is subject to stamp duty as an “instalment purchase agreement” under stamp duties legislation.
- The transaction is not considered to be a loan.

(2) An instalment (or conditional) sale under which ownership of the goods does not pass to the consumer until full payment is made. This in fact is a hire-purchase agreement under the definition in the uniform hire-purchase legislation.

- The seller has limited security which can be displaced by the claim of a subsequent purchaser in good faith and without notice.
- The consumer has the benefit of the implied conditions on merchantability, etc under the hire-purchase legislation.
- Because the seller retains ownership, the security avoids registration as a bill of sale (¶13-070ff).
- Subject to stamp duty as an “instalment purchase agreement” under stamp duties legislation.

(3) A hire-purchase agreement (¶14-060). This is a letting of goods to the consumer/hirer with an option available to the consumer/hirer to purchase the goods.

- Subject to the uniform hire-purchase legislation.
- The consumer has the benefit of the implied conditions on merchantability, etc under this legislation.
- Subject to stamp duty as an “instalment purchase agreement” under stamp duties legislation.

(4) An instalment sale under which ownership immediately passes to the consumer along with a bill of sale (¶13-070ff) from the consumer over the goods to secure the transaction.

- Ownership passes on the making of the agreement.
- Seller has security under the bill of sale which cannot be displaced by the rights of a subsequent purchaser in good faith and without notice.
- Subject to stamp duty as an “instalment purchase agreement” under stamp duties legislation.

(5) A chattel mortgage, ie an instalment sale under which ownership of the goods passes immediately to the consumer but where the consumer gives a chattel mortgage in the form of an unregistered bill of sale to the supplier as security (¶13-070ff).

- Subject to stamp duty as an “instalment purchase agreement” under stamp duties legislation.

(6) A budget account, ie a cash sale together with a separate unsecured credit transaction. This may involve a bipartite credit account between supplier and consumer, known as a budget account or a revolving credit account (cf the tripartite arrangement involved with Bankcard and other charge cards (§16-690)).

- The credit is arguably not a loan under the State moneylenders legislation.

(7) A cash sale together with a separate secured credit transaction in the form of a registered bill of sale.

(8) A cash sale together with a chattel mortgage as security (ie an unregistered bill of sale). The effect of non-registration is noted at §13-140.

- Not subject to stamp duty because transaction is not an “instalment purchase agreement”.
- Seller has security which in certain cases cannot be displaced by the rights of a subsequent purchaser in good faith and without notice.

(9) A cash sale paid direct to the seller from independently provided finance. This bypasses the need for the seller to provide the credit (as in examples (1)-(8)) and is achieved by the supplier selling the goods to an independent credit provider or financier and an independent transaction between this person and the consumer (which may take the form of examples (1)-(5)).

(10) A cash sale paid by the buyer from independently provided finance. The essence of this transaction is the loan made by the independent credit provider or financier direct to the consumer.

- The financier must be licensed under the State moneylenders Acts.
- The consumer does not have the benefit of any implied conditions on merchantability, etc as would be the case under the uniform hire-purchase legislation.

(11) An independent credit provider or financier may provide finance, not direct to the consumer but by purchasing the seller's rights or by making a loan on the security of those rights. Notice of assignment may or may not be given to the consumer.

Other forms of transactions include lay-by sales, where the seller retains ownership and possession until the goods are paid for, and leasing, where the consumer/lessee has the benefit of the possession and use of the goods but has no rights of ownership.⁷

§14-040 Defects in former consumer credit law. The various forms of consumer credit noted at §14-030 present the consumer, seller and

7. A lease agreement may be categorised as repayment of a loan and credit charges (ie not a true rental) falling within the provisions of Pt III of the *Credit Act* (§14-150; §14-180): *Morlend Finance*

Corporation (Vic) Pty Ltd v Dover (1988) ASC ¶55-651; *Stateside Credit Corporation Pty Ltd v Hudson* [1989] VR 519; (1988) ASC ¶55-696 (Full Court).

credit provider with, in the words of the Rogerson Report, “unnecessarily complicated and multifarious methods (to carry on) instalment credit transactions and moneylending in the consumer field”.⁸ Each form achieves one main result, namely the advancing of money or credit to a consumer to enable the purchase of goods or services; but each form contains significant variations in the rights and the protections to all parties. Some forms favour consumers, others suppliers, others credit providers; this is why the various forms are in use.

The UK Crowther Committee (1971)⁹ identified seven defects in the then consumer credit law:

- (1) Regulation of transactions according to their form instead of according to their substance.
- (2) The failure to distinguish consumer from commercial transactions.
- (3) The artificial separation of the law relating to lending from the law relating to security.
- (4) The absence of any rational policy in relation to third party rights.
- (5) Excessive technicalities.
- (6) Lack of consistent policy in relation to sanctions for breach of statutory provisions.
- (7) Overall, the irrelevance of credit law to present day requirements, and the resulting failure to provide just solutions to common problems.

These defects are illustrated in the study of bills of sale law at ¶13-070ff.

¶14-050 Reform or updating of consumer credit law.

Moves towards the reform or updating of consumer credit law began in 1958 and 1959 when the laws on consumer credit and moneylending were examined on a national basis by Commonwealth and State Ministers. As a result of this, each State and the two Territories passed hire-purchase legislation in 1959/1961 based on a uniform Bill.

Passing of the *Truth in Lending Act 1968* (US) was one of the factors stimulating reform of Australian consumer credit laws.

In 1969, a South Australian Committee under Professor (later Judge) Rogerson (see ¶14-040) recommended replacing hire-purchase with new forms called a credit sale and a chattel mortgage. It also made a number of wide ranging recommendations on the subject of the reform of consumer credit law. These recommendations were introduced in part as the former *Consumer Credit Act 1972* (SA) and the *Consumer Transactions Act 1972* (SA), legislation which

8. Committee of the Adelaide Law School, *The Law Relating to Consumer Credit and Moneylending*, Government Printer, Adelaide, 1969 (Rogerson Report), p 8, noted at ¶14-050.

9. *Report of the Committee on Consumer Credit* (the Crowther Report), UK, 1968-1971, Cmnd 4596.

repealed the existing *Hire-Purchase Agreements Act 1960* (SA) and *Money-lenders Act 1940* (SA) and replaced them with modern credit legislation.¹⁰

¶14-060 Summary of hire-purchase law. As introduced at ¶13-050, a hire-purchase agreement is a contract of hire for a fixed period at a fixed rental which grants the hirer an option to buy. Available for over a century, hire-purchase has provided many benefits to the hirer and financier. It has benefited the hirer by enabling goods to be made available on credit terms or by instalments while providing security for the owner. Because of its retention of ownership, the owner can repossess the goods under the *nemo dat* rule (¶13-270) from a defaulting purchaser or even from an innocent purchaser to whom the original purchaser may have resold the goods. The hirer has always been able to end the agreement by paying moneys owing.

A hire-purchase transaction usually involves three parties — the seller, its customer and a third party finance company. The seller does not sell to its customer but to the financier, and the financier then hires the goods to the customer. The financier becomes the “owner” and the customer is the “hirer”. The actual hire-purchase agreement consists of a hiring of the goods by the owner to the hirer with an irrevocable option to purchase, and a purchase of the goods by the hirer by instalments. The arrangement “envisages the probability of permanent alienation. In short, unlike hire, [hire-purchase] is essentially a security transaction.”¹¹ Instead of having the status of buyer, the person “buying” holds the position of “hirer”. The hirer has no ownership of the property hired until the last instalment has been paid, at which time the hirer’s option to purchase may be exercised, but the hirer may exercise the option earlier.

Hire-purchase resembles a conditional sale in that each form of transaction gives “rights” before final transfer of ownership. But whereas the hirer under hire-purchase has an *option* to purchase the goods, the buyer in a conditional sale is under a *legal obligation* to purchase. The major distinction is that a hire-purchase hirer unlawfully disposing of the goods cannot pass good title to a purchaser,¹² while a buyer on conditional sale unlawfully disposing of goods

10. At about the same time as the Rogerson Report, and in the succeeding years, a number of other Committees and Commissions were investigating the law of consumer credit and were presenting reports recommending change. These included the Crowther Committee (UK 1971: ¶14-040), the New Zealand Contracts and Commercial Law Committee (1971), the Law Reform Commission of Queensland (1972), the Western Australian Honorary Royal Commission (1972), the Law Council of

Australia Committee (the Molomby Report 1972: ¶14-070), the Australian Government Commission of Inquiry into Poverty (1975, 1977) and the Australian Law Reform Commission’s General Insolvency Inquiry Report (1988: ¶13-558).

11. Fleming, JG, *Tort liability for damage to hire-purchase goods* (1959) 32 ALJ 267 at p 271.

12. Subject to chattel securities legislation: ¶14-370.

may be able to pass good title to a purchaser. This essential characteristic of hire-purchase was established from the earliest cases.¹³

Hire-purchase makes the goods immediately available to the hirer and contrasts with a credit sale and a lay-by. Under a lay-by the buyer has no use of the goods until the making of the last payment, and the seller who retains possession is put to the expense and risk of having to store the goods.

The contrast between hire-purchase and sale on credit secured by a mortgage (a bill of sale: ¶13-070ff) is that the interest of the mortgagee/creditor is at risk and could be set aside for non-compliance if any of the many technicalities prescribed by the law are not complied with.

The essential features of hire-purchase can be summarised as follows:¹⁴

- (1) The hirer has an “equity” in the goods in the sense of a statutory option to purchase upon completion of all payments. This is not a proprietary right and the hirer’s “equity” — the right to possession and the right to use the goods in accordance with the agreement — comes from the hire-purchase agreement under which the hirer is a bailee. The hirer has the right to acquire full ownership at any time by payment in full.
- (2) The law recognises the owner’s ownership of the goods unless the arrangement is artificial, for example to defeat creditors,¹⁵ but the owner is not protected from a possessory lien created by a repairer against the hirer (¶13-260). The owner has the right to payment of rent instalments for the period the hirer is in possession. Legally the “deposit” is consideration by the hirer for the owner’s granting an option to purchase. When the hirer pays the last hire-purchase instalment, the hirer exercises the option to purchase and becomes the owner of the goods.
- (3) There are rigid requirements on formalities such as what must be written, what must be described, and what may not be described. The goods must correspond with the goods in the agreement.
- (4) Conditions and warranties are implied into the hire-purchase agreement which parallel those in the *Trade Practices Act 1974* (Cth) and the sale of goods legislation (¶7-035 — ¶7-090) dealing with title, merchantable quality and fitness for purpose.¹⁶ Unlike the position under the sale of goods legislation (except in consumer transactions: ¶7-170), the hire-purchase implied conditions cannot be excluded.¹⁷ Not only the seller but the financier is made responsible for these implied conditions and warranties as “owner” (¶14-210), even though hire-purchase legislation provides for some indemnity to the financier from the seller.

13. eg *McEntire v Crossley Bros Ltd* [1895] AC 457; *Helby v Matthews* [1895] AC 471.

14. Based on Corr, V and Begg, S, *Legal aspects of credit plans of financiers and retailers* (1964) 38 LIJ 366 at pp 372-374.

15. eg *Price v Parsons* (1936) 54 CLR 332.

16. *Hire-Purchase Act 1959* (Qld) sec 5; 1959 (WA) sec 5; 1959 (Tas) sec 9.

17. See further Cavanagh, SW, *Defective goods under hire-purchase: the effect of the new credit legislation* (1985) 8 UNSWLJ 256.

- (5) The financier is made responsible for specific representations and warranties given by the dealer.
- (6) The hirer has various statutory rights such as 21 days in which to make good default in the event of repossession — the loss of the contractual right to possession — and the right to a copy of the agreement, etc. The hirer also has the right to terminate the contract without future liability but is responsible for amounts due under the contract.
- (7) The owner has the right to repossession if the hirer defaults. The owner must comply with the requirements of the hire-purchase agreement, such as giving the hirer warning of impending repossession.

The hire-purchase legislation therefore regulates three main aspects of hire-purchase transactions:

- (1) Information to be given to prospective hirers is set out in the uniform hire-purchase legislation.¹⁸ This includes a First Schedule Notice, which is a relatively simple statement of the hirer's financial obligations under the proposed hire-purchase agreement and is to be given before the agreement is entered into. This section also details the form and contents of the hire-purchase agreement (in writing; to be signed; to specify dates, numbers, amounts and timing of instalments; and to provide a description of the goods and the contractual details in tabular form regarding price, amount paid, insurance, other charges, etc).
- (2) Conditions and warranties are implied into the hire-purchase agreement, as discussed above.
- (3) Termination of the hire-purchase agreement and repossession are dealt with in the hire-purchase legislation. If the hirer is in breach of contract, the owner, entitled to repossess, must first serve a Third Schedule Notice of Intention to Repossess under the Act.¹⁹ Following repossession by compliance with the statutory formalities, the owner within 21 days after repossession must advise the hirer of the right to get the goods back by reinstating or finalising the agreement, and the extent of the hirer's liability for failure to reinstate or finalise the agreement. If this notice is not served under the Act, "the rights of the owner under the hire-purchase agreement hereupon cease and determine".

Consumer v seller. Because there is no contract of sale between the seller and the consumer (the hirer), the hirer cannot sue the seller for breach of contract. (There may be the right to sue the seller for breach of a collateral contract: ¶6-030.) The legislation overcomes this by extending to the hirer the common law right to damages for breach of a representation, warranty or statement.²⁰ This right is non-excludable. For example, an owner-driver was entitled to terminate his hire-purchase contract for a prime mover (with the owner) for breach of warranty by the seller that its engine had been fully reconditioned.²¹

18. *Hire-Purchase Act 1959* (Qld) sec 3; 1959 (WA) sec 3; 1959 (Tas) sec 5.

20. *Hire-Purchase Act 1959* (Qld) sec 6; 1959 (WA) sec 6; 1959 (Tas) sec 10.

19. *Hire-Purchase Act 1959* (Qld) sec 13; 1959 (WA) sec 13; 1959 (Tas) sec 17.

21. *Burns v MAN Automotive (Aust) Pty Ltd* (1986) 161 CLR 653; (1986) 61 ALJR 81.

The rights of the consumer are also governed by the misleading or deceptive conduct and misrepresentation provisions of statutes such as the *Trade Practices Act 1974* (Cth) and *Fair Trading Act* equivalents (¶17-250ff). In addition, the consumer may have rights against the seller under the tort of negligence and negligent mis-statement.

Consumer v owner. Because the only contract of the consumer is the hire-purchase contract with the financier/owner, hire-purchase legislation implies conditions of merchantability, etc into every hire-purchase contract, and the owner — ie often the financier — is responsible for them. The owner can be sued for damages for non-delivery of the goods under the agreement.

Regulation of hire-purchase. The Consumer Credit Code regulates all Australian hire-purchase by consumers where the amount paid by the consumer is more than the price of the goods. The Consumer Credit Code treats hire-purchase as a “sale by instalments” which is credit regulated by the Code (sec 10) if it is for personal, domestic or household purposes (sec 6) (¶14-150). The hire-purchase legislation has been abolished in New South Wales, South Australia, the Northern Territory and the ACT.

The hire-purchase legislation now exists in only three jurisdictions,²² and it applies only to non-consumer transactions such as those of small business and farmers which are not covered by the Consumer Credit Code: Queensland,²³ Western Australia,²⁴ and Tasmania.²⁵

¶14-065 Hire-purchase at common law. Hire-purchase transactions falling outside the definition of a “credit contract”²⁶ and therefore not regulated by the essentially uniform consumer credit legislation (¶14-070—¶14-155), or those existing in jurisdictions without hire-purchase legislation (see ¶14-060 above), exist as commercial leasing, bailment arrangements or hire-purchase at common law, and remain governed by the common law. For example, “floor plan” or stock-in-trade financing (¶13-350) fall outside the hire-purchase legislation. These arrangements enable a dealer to finance the purchase of goods through a finance company while maintaining stock for sale.

Issues arising from common law hire-purchase transactions include:

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22. The *Hire-Purchase Act 1959* (Vic) was amended from 1 July 1998 by the *Hire-Purchase (Further Amendment) Act 1997* (Vic) to limit the operation of the *Hire-Purchase Act* to hire-purchase accounts in force before 1 July 1998. The *Hire-Purchase (Amendment) Act 2000* (Vic) extends the Act to farm machinery to 30 June 2003.
 23. *Hire-Purchase Act 1959* (Qld), sec 2(1) “hire-purchase agreement”.
 24. The *Hire-Purchase Act 1959* (WA) can be declared by order not to apply to “a specified class of persons”: sec 2A(1), added 1995. (This could include consumers.)
 25. The *Hire-Purchase Act 1959* (Tas) does not apply to consumer credit covered by the Consumer Credit Code: sec 4A, added in 1996.
 26. The financing transaction of a commercial vehicle described by the financier as “commercial hire purchase” was held to constitute a “loan contract” regulated by the *Credit Act* Pt III (¶14-150; ¶14-180): *Stateside Credit Corporation Pty Ltd v Hudson* [1989] VR 519; (1988) ASC ¶55-696.

(1) Statutory implied conditions. As the transaction does not import the statutory implied conditions of the hire-purchase legislation, is it a "sale" which thereby attracts the implied conditions of the *Trade Practices Act* and the sale of goods legislation (§7-035ff)? Case law basically upholds a common law hire-purchase as a sale of goods upon the exercise of the option to purchase complete with sale of goods statutory implied conditions as to title, description, merchantability, fitness for purpose and sample.²⁷

(2) The hirer's interest is contractual (the benefit of the hire-purchase agreement), not proprietary, and can be assigned. A hirer cannot make a sale or pledge without the authority of the owner.²⁸ Alternatively, the hirer's interest can be analysed as an option to purchase, a chose in action similarly capable of assignment. As the hirer's interest increases with each payment, any damages for conversion would be for the amount outstanding and not the full amount as is usual in conversion.²⁹

(3) The hirer at common law can be prevented from assigning its interest³⁰ by the incorporation of a term in the contract terminating the agreement upon disposition of the goods. Only if the owner is then entitled to possession (probably upon the giving of notice) can the owner bring action against the third party for conversion. Hence analysis of the transaction would have to show that upon breach of the agreement by the hirer, the owner regained the right to immediate possession of the goods.³¹

(4) Premature termination. A common law hirer terminating early and returning the goods to the owner forfeits all rights over those goods. The hirer is not entitled to any profit on resale, and may be liable in damages for breach of contract for payments owing,³² agreed damages (if a genuine pre-estimate), and consequential damages as at the date of termination.³³

¶14-067 Consumer leases. A consumer lease, a contract for the hire of goods by a person or strata corporation, is regulated by the Consumer

27. eg *Felston Tile Company, Ltd v Winget Ltd* [1936] 3 All ER 473; *Star Express Merchandising Company Pty Ltd v McGrath Pty Ltd* [1959] VR 443.

28. *Hartop v Hoare* (1743) 3 Atk 44; 26 ER 828, where the pledgee was held liable for conversion when the goods pledged were put into the possession of the pledgor for safe custody.

29. *Belsize Motor Supply Company v Cox* [1914] 1 KB 244.

30. cf *Hire-Purchase Act 1959* (Qld) sec 9; 1959 (WA) sec 9; 1959 (Tas) sec 13.

31. eg *North General Wagon & Finance Co Ltd v Graham* [1950] 2 KB 7; *Reliance Car Facilities Ltd v Roding Motors* [1952] 2 QB 844 at p 849; Nolan, BR,

Determination of hiring in hire-purchase agreements. Owner's action for conversion or detinue (1935) 9 ALJ 362 at pp 362-363.

32. *Yeoman Credit, Ltd v Waragowski* [1961] 3 All ER 145; [1961] 1 WLR 124, though the courts have power to grant relief against the sum contained in an agreed damages or "minimum-payment" claim; *Bridge v Campbell Discount Co Ltd* [1962] AC 600: "The 'minimum-payment' clause is single and indivisible, and no just distinction can be drawn between the cases where the hirer is in breach and where he is not", per Lord Denning MR at p 631.

33. cf *Hire-Purchase Act 1959* (Qld) sec 12; 1959 (WA) sec 12; 1959 (Tas) sec 15.

Credit Code if there is no right or obligation to purchase the goods hired. Traditionally, neither the Hire Purchase Acts nor the former Credit Acts covered a lease of goods which did not intend the lessee to own the goods at the end of the agreement. Only South Australia had legislation for the regulation of consumer leases.³⁴

Certain consumer leases are not regulated by the Code, such as consumer leases for a fixed period of four months or less, consumer leases for an indefinite period, and employment related leases. Consumer leases of a certain class may be excluded, by the Regulations, from the operation of the Code.³⁵

One of the key features of a consumer lease is that it is entered into for consumer purposes. To help determine whether this is the case, two predominant purpose tests have been devised:

- (1) the predominant purpose for which goods are hired is the purpose for which more than one half of the goods are intended to be used; or
- (2) the predominant purpose for which goods are hired is the purpose for which the goods are intended to be most used.

THE CONSUMER CREDIT LEGISLATION _____

Reform of consumer credit law:
the Molomby Report (1972) ¶14-070
Australian consumer credit law ¶14-080
Assessment of the former consumer credit legislation .. ¶14-125
What is “credit”? ¶14-130
Consumer credit contracts: overview ¶14-140
Consumer credit contracts ¶14-150
Consumer credit legislation: benefits to consumers
and lenders ¶14-155

¶14-070 Reform of consumer credit law: the Molomby Report (1972). The Report of the Molomby Committee contained far-reaching recommendations for the reform of consumer credit laws with some reforms to carry over into the area of business credit (¶14-030).³⁶ In 1977 the Standing Committee of Attorneys-General decided to have draft model Bills prepared for uniform consumer credit legislation which might be adopted and enacted by each State and Territory on a uniform basis.

34. A number of the provisions of Pt II, Div II of the *Consumer Transactions Act 1972* (SA) were echoed in Pt 10 of the Consumer Credit Code.

35. Consumer Credit Code sec 149(3).

36. A Committee of the Law Council of Australia, *Report on Fair Consumer Credit Laws*, Melbourne, Government Printer, 1972 (the Molomby Report).

¶14-080 Australian consumer credit law

New South Wales. The *Consumer Credit (New South Wales) Act 1995* (NSW), which contains the *Consumer Credit (New South Wales) Code* based on the Queensland template with some minor changes, replaced the *Credit Act 1984* (NSW) and other related laws such as the moneylenders legislation. However, the *Credit Act* still applies to regulated contracts entered into before 1 November 1996.

The bills of sale legislation regulates non-consumer securities (¶13-060).

The *Registration of Interests in Goods Act 1986* (NSW) was passed to provide a consistent treatment of all mortgages falling within the area of consumer credit and the protection of bona fide purchasers of goods who have bought for value without notice of any existing security interests in motor vehicles (¶14-320—¶14-380). The Act was amended by the *Registration of Interest in Goods Amendment Act 1999* to bring the legislation in line with the recommendations made by Professor Tony Duggan (see ¶14-340).

New South Wales also introduced negative licensing of credit providers in 1996 instead of licensing, with the conduct of credit providers supervised by the Department of Fair Trading.

Victoria. The *Consumer Credit (Victoria) Act 1995* (Vic) applies the Queensland template in Victoria. The Victorian Act also provides for the licensing of credit providers (¶14-270)³⁷ and provides for the establishment of a Consumer Credit Fund into which amounts of civil penalty are to be paid.³⁸ The *Hire-Purchase Act 1959* (Vic) was amended from 1 July 1998 to apply only to hire-purchase contracts before that date, and it was extended to 30 June 2003 with respect to farm machinery agreements.

The Act repealed the earlier *Credit Act 1984*, which had repealed the earlier moneylenders legislation and had excluded hire-purchase from the consumer area. However, the *Credit Act* still applies to regulated contracts entered into before 1 November 1996.

The *Chattel Securities Act 1987* (Vic), which has not been affected by the Code, aims to strike a balance between the rights of secured parties who lend money or sell goods on the security of goods (chattels) and the rights of third parties such as purchasers, later lenders, auctioneers and commission agents who acquire the goods or who deal with them unaware of the existence of earlier securities. The 1987 Act changed the common law rules with respect to the separation and priority of interests in goods (chattels), aimed to protect third parties who purchased goods for value without notice of an existing undischarged security interest and repealed the earlier bills of sale legislation (¶13-070ff). Specific changes effected by the *Chattel Securities Act 1987* (Vic) include the common treatment of mortgages, charges, leases and hire-purchase agreements (sec 3); the modified definition of a security interest as a legal

37. *Consumer Credit (Victoria) Act 1995* (Vic), Pt 4 (sec 10-37). 38. *Credit (Administration) Act 1984* (Vic) Pt 5A, added 1996.

interest doing away with the earlier notion of a “statutory charge” (sec 5); and the establishment of the secured party’s rights to the balance of the unpaid purchase price (sec 7(7)).³⁹ The Act is administered by the Roads Corporation. The Act was amended by the *Chattel Securities Amendment Act 1998* to bring the legislation in line with the recommendations made by Professor Tony Duggan (see ¶14-340).

Queensland. Under the MCCA agreement (¶14-010), Queensland was the State chosen to enact the agreed model or “template” legislation and regulations comprising the Consumer Credit Code.

As the first step towards a national consumer credit code, Queensland passed the *Consumer Credit (Queensland) Act 1994* (Qld), containing the Code to replace the *Credit Act 1987* (Qld). However, the *Credit Act* still applies to regulated contracts entered into before 1 November 1996.

The Act applies the Code as a law of Queensland under the name *Consumer Credit (Queensland) Code*. The *Consumer Credit (Queensland) Act* abolished the earlier *Credit Act 1987* (Qld).

The bills of sale (¶13-070) and the hire-purchase legislation regulates non-consumer transactions in Queensland (¶14-060).

In addition, Queensland provides for a motor vehicles securities register (¶14-320—¶14-380).

Western Australia. The *Consumer Credit (Western Australia) Code*—similar to but not identical with the Queensland template Code—is an Appendix to the *Consumer Credit (Western Australia) Act 1996* (WA). Western Australia agreed with the general thrust of the template Code, but did not wish to join the national scheme because under the MCCA agreement (¶14-010), amendments enacted in Queensland would have to be automatically adopted in Western Australia. For example, one minor difference is the use in the Western Australian Code of penalties expressed in dollar terms, not penalty units (¶14-300).

This legislation repeals the earlier *Credit Act 1984* (WA) and related legislation. However, the *Credit Act* still applies to regulated contracts entered into before 1 November 1996.

The hire-purchase legislation regulates non-consumer transactions in Western Australia (¶14-060).

In addition, Western Australia provides for registration of chattel securities and bills of sale (¶13-060, ¶13-160), and a motor vehicles securities register (¶14-320—¶14-380).

South Australia. The *Consumer Credit (South Australia) Act 1995* (SA) applies the Queensland template Code in South Australia. This Act repealed the

39. See, eg, Carroll, P, *Competing interests*
— *new chattel security* (1987) 61 LIJ 550.

earlier *Consumer Credit Act 1972* (SA). However, the *Consumer Credit Act* still applies to regulated contracts entered into before 1 November 1996.

The bills of sale legislation regulates non-consumer securities (§13-060) and the *Goods Securities Act 1986* (SA) established a motor vehicles security system (§14-320—§14-380). The Act was amended by the *Goods Securities (Miscellaneous) Amendment Act 2000* to bring the legislation in line with the recommendations made by Professor Tony Duggan (see §14-340).

Tasmania. The *Consumer Credit (Tasmania) Act 1995* (Tas) applies the Queensland template Code in Tasmania under the name *Consumer Credit (Tasmania) Code* as Tasmania's first modern consumer credit legislation: Tasmania had not passed a Credit Act in the 1980s.

The bills of sale (§13-060) and the hire-purchase legislation regulates non-consumer transactions in Tasmania (§14-060).

In addition, Tasmania provides for a motor vehicles securities register (§14-320—§14-380).

Australian Capital Territory. The *Consumer Credit Act 1995* (ACT) applies the Queensland template in the ACT under the name *Consumer Credit (Australian Capital Territory) Code*, replacing the earlier *Credit Act 1985* (ACT). However, the *Credit Act* still applies to regulated contracts entered into before 1 November 1996.

The bills of sale legislation regulates non-consumer securities (§13-060) and the ACT provides for a motor vehicles securities register (§14-320—§14-380).

Northern Territory. The *Consumer Credit (Northern Territory) Act 1995* (NT) applies the Queensland template Code in the Northern Territory under the name *Consumer Credit (Northern Territory) Code* as the Northern Territory's first modern consumer credit legislation. The Northern Territory had not passed a Credit Act in the 1980s.

The bills of sale legislation regulates non-consumer securities (§13-060) and the Northern Territory provides for a motor vehicles securities register (§14-320—§14-380).

In addition, the linked credit provider provisions of the *Credit Act* were re-enacted in the *Consumer Affairs and Fair Trading Act 1990* (NT).⁴⁰

§14-125 Assessment of the former consumer credit legislation. The advantages of consumer credit legislation to consumers and lenders are set out at §14-155. In particular, the former *Credit Act 1984* (Vic), (NSW), (WA); 1985 (ACT); 1987 (Qld) and the former *Consumer Credit Act 1972* (SA) led to the following achievements:

- *National approach.* Pioneered by the *Consumer Credit Act 1972* (SA) (now repealed) and the *Consumer Transactions Act 1972* (SA), the

40. Part V Div 4 (sec 83-86): §14-210.

enacting of the *Credit Act* introduced the first modern consumer credit laws covering most Australians (except those in Tasmania and the Northern Territory). The consumer credit legislation attempted to be essentially national and uniform in operation.

- *Legal expertise.* The *Credit Act* led to the development of legal expertise in the area of consumer credit with the development of a body of case law from the Credit Tribunals and the courts.
- *Recognition of consumer rights and interests* with, for example, improved disclosures, notices and procedures for variation.
- *Recognition of the rights of credit providers* including uniformity of documentation.
- *Encouragement of compliance* and enforcement by means of automatic civil penalties which required the credit provider to approach the appropriate tribunal to reinstate the charges automatically lost because of a certain breach of the *Credit Act*.

Disadvantages of the former *Credit Act* included:

- *State/Territory laws.* Although the credit laws were essentially uniform, they were contained in different statutes in each of the jurisdictions. There was no consumer credit legislation in Tasmania and the Northern Territory. The laws had no national reach, and were not “cross-referenced” to each other with cross-vesting provisions as are now contained in the Consumer Credit Code (eg sec 101(2), 105(1), 108, 109). The same conduct could be litigated separately in different jurisdictions. In the case of penal offences, there was no protection from “double jeopardy” — a credit provider could be prosecuted for the same conduct in different jurisdictions. (Section 181 of the Code now provides for cross-vesting, and prevents an offender from being punished twice for the same offence in different jurisdictions.)
- *Inconsistencies.* The *Credit Act* was inconsistent in respect of the monetary jurisdiction (\$20,000, but \$40,000 in Queensland).
- *Limited operation.* The Credit Acts mostly applied to finance companies, and they did not apply to most lending by building societies, some bank lending, lending by credit unions (except in Victoria and Western Australia), lending by co-operatives, home loans, home mortgages and, through its related sale provisions, the contract for the sale of land. The monetary test of \$20,000/Qld \$40,000 limited the services covered by the *Credit Act*. (Now the unlimited scope of “services” means the Code applies to real estate and conveyancing, and that a purchaser may be able to terminate a contract under the Code after the expiry of a “cooling off” period (§3-450) or a “subject to finance” clause (§5-250).)
- *Inflexibility.* The *Credit Act* resulted in inflexibility in pricing and product design.
- *Automatic forfeiture.* Credit providers faced automatic forfeiture of

interest for breach of the *Credit Act*. Civil penalties are now capped at \$500,000: ¶14-290.

- *Convoluting language*. Although the Code is not written in “plain English”, its drafting is an improvement over the *Credit Act*.

¶14-130 What is “credit”? Credit means an advance of money or money’s worth with the expectation of repayment. Section 4 of the Code explains that:

“... ‘credit’ is provided if under a contract—

- (a) payment of a debt owed by one person (the debtor) to another (the credit provider) is deferred; or
- (b) one person (the debtor) incurs a deferred debt to another (the credit provider).”

The amount of credit is the amount of the debt actually deferred (sec 4(2)).

¶14-140 Consumer credit contracts: overview. The Consumer Credit Code regulates the following consumer credit arrangements of banks, finance companies, building societies, credit unions, retailers providing credit, and any other person or company providing relevant credit in the course of any business:

- credit contracts (Part 2);
- continuing credit contracts;
- contracts for the sale of goods or services by instalments, including hire-purchase (sec 10);
- consumer leases (Part 10);
- other credit contracts, such as personal loans, bank term loans and housing loan contracts.

In addition, the Code applies to the following “related” transactions:

- related mortgages (Part 3 Div 1);
- related guarantees (Part 3 Div 2);
- related sale contracts (Part 7); and
- related insurance contracts (Part 8).

Some classes of credit to which the Consumer Credit Code does not apply include:

- short term credit — not exceeding 62 days (sec 7(1));
- credit without prior agreement (sec 7(2));
- bill facilities (sec 7(5); ¶16-560); and
- certain employee loans (sec 7(9)).

The Code does not apply, except for the reopening of unjust transaction provisions (¶14-240), to:

- credit provided by pawnbrokers (sec 7(7); ¶13-220), and

- credit provided to beneficiaries by trustees appointed under a will (sec 7(8); ¶9-755).

These are all discussed further in ¶14-150.

Listed are the former and current names for the following agreements:

<i>Former name</i>	<i>Current name</i>
hire-purchase or goods lease with option to purchase	sale of goods by instalments (sec 10), ie a credit contract, possibly with a goods mortgage
goods lease with no option to purchase	consumer lease
bank, finance company or credit union personal loan, moneylender	loan contract
Bankcard and other credit cards	continuing credit contract
personal loan with a bill of sale or chattel mortgage (¶13-070ff; ¶14-030)	loan contract with a related mortgage ⁴¹
retail store single item credit with an equitable charge or mortgage over goods (¶13-047; ¶13-048)	credit contract with a goods mortgage
retail store monthly charge account	continuing credit contract

¶14-150 Consumer credit contracts. The Consumer Credit Code regulates the activities of all financial institutions and other providers of personal credit, including banks, finance companies, credit unions, building societies, retailers providing credit and any other person or company providing credit in the course of any business (sec 6).

Section 6(1) of the Code provides that credit is regulated if:

- the debtor is a natural person or a strata corporation;
- the credit is provided “wholly or predominantly” for personal, domestic or household purposes;⁴²
- a charge is made for the credit; and
- the credit is provided in the course of the business of the credit provider.

41. eg under the *Bills of Sale Act 1900* (Tas) sec 4A, where a bill of sale secures the provision of consumer credit as defined by the Consumer Credit Code, any provision of the Code that is inconsistent with the Act prevails: ¶13-070.

42. The Code may apply to a transaction with mixed purposes: partly personal and partly business.

The Code regulates all credit provided under a contract in the course of the credit provider's business unless there is an exemption. The credit must be for the personal, domestic or household purposes of an individual including personal loans, bank term loans, overdrafts, credit card facilities, credit and debit facilities (to the extent that credit is provided), housing loans, hire-purchase agreements, consumer leases and retail credit. Borrowing for investment is exempted (sec 6(4)).

Section 7 exempts some credit from some provisions of the Code:

- (1) Short term credit of up to 62 days.
- (2) Credit without prior arrangement (such as a cheque account going into debit).⁴³

— *Example* —

The Code applies where a charge is made for providing credit (sec 6). However, a creditor can charge interest on an overdue account because this is credit provided without prior arrangement (exempted under sec 7(2)). Therefore the creditor does not need to register as a credit provider. However, if the creditor makes an arrangement to give the debtor time to pay, the arrangement will be regulated by the Code because of sec 6.

- (3) Credit under a continuing credit contract for which an account charge is payable which does not vary according to the amount payable — such as a charge card.⁴⁴
- (4) Joint credit and debit facilities. For example, an overdraft account is not regulated if it has a positive balance.
- (5) Bill facilities (¶16-560) or promissory notes (¶16-615).
- (6) Insurance premiums by instalments, even if the instalments exceed the total of the premium.
- (7) Pawnbrokers (¶13-220). However, the re-opening provisions in sec 70-72 apply to pawnbrokers (sec 7(7)).
- (8) Credit provided by the trustees of a deceased estate to a beneficiary or prospective beneficiary. However, the re-opening provisions in sec 70-72 (¶14-240) apply to any provision of credit (sec 7(8)).
- (9) Credit provided by an employer to an employee.⁴⁵

The consumer credit contracts regulated by the Code are:

- (1) *Credit contracts*. Section 6 provides that the credit will be regulated by the Code if the debtor is a natural person (or a strata corporation); the credit is provided predominantly for personal, domestic or household

43. eg Cutler, P, *Does the Consumer Credit Code apply to solicitors bills* (sic) (1998) 36(2) LSJ 54.

44. Under sec 5 of the *Consumer Credit Regulation 1995*, the maximum charge is

\$200 for the first 12 months, and \$125 for any subsequent period of 12 months.

45. Pt 4 Div 3, Pt 5 Div 4 and 5, Pt 7 and Pt 11 Sch 1 and 2 are not excluded from sec 7(9).

purposes; there is or is not a credit charge, and it is provided in the course of the credit provider's business. There is no monetary threshold in this definition.

- (2) *Continuing credit contracts.* As defined in Schedule 1, continuing credit contracts have two aspects: "(a) multiple advances of credit are contemplated; and (b) the amount of available credit ordinarily increases as the amount of credit is reduced." Credit cards and overdrafts are continuing credit contracts, but a contract where more than one advance is contemplated such as a construction housing loan is not "revolving" or "come and go" in nature.
- (3) *Contracts for the sale of goods by instalments*, including hire-purchase. Hire-purchase agreements (¶13-050) are deemed by sec 10 of the Code to be regarded as a sale of the goods by instalments and are regulated as "credit contracts". A "wink and nod" understanding that a lessee can acquire the leased goods at the end of a finance lease is probably not a credit contract if it is only an understanding and not a "contract" as defined in Schedule 1.
- (4) *Consumer leases.* As defined in sec 147, a consumer lease is "a contract for the hire of goods by a natural person or strata corporation under which that person or corporation does not have a right or obligation to purchase the goods". Consumer leases are regulated under Part 10 (sec 147-157) if the goods are hired wholly or predominantly for personal, domestic or household purposes and a charge is made (sec 148) less the exemptions set out in sec 149 dealing with short term leases, indefinite leases and employment related leases (¶14-067). There is no exemption for consumer leases with an investment purpose. Consumer leases were not regulated by the Hire-Purchase Acts or by the Credit Acts (1984-1989) because they did not intend the lessee to own the goods at the end of the agreement. Only South Australia had legislation for the regulation of consumer leases.
- (5) *Other credit contracts*, such as personal loans, bank term loans and housing loan contracts.

In addition, the Consumer Credit Code applies to the following "related" transactions:

- (a) *Related mortgages:* Part 3 Div 1. The Code applies to a mortgage if it secures obligations under a credit contract, or a related guarantee, and the mortgagor is a natural person or a strata corporation (sec 8). As mentioned above, the Code only applies to the provision of credit for personal, domestic or household purposes by a credit provider in the course wholly or predominantly of business; mortgages for commercial or investment purposes are not covered by the Code. (See ¶14-180.)
- (b) *Related guarantees:* Part 3 Div 2. The Code applies to a guarantee if it secures obligations under a credit contract, and the guarantor is a natural person or a strata corporation (sec 9). (See ¶14-180.)
- (c) *Related sale contracts:* Part 7. The Code applies to a contract (or a

proposed contract) for the sale of goods or services if it is (or is proposed to be) financed by credit to which the Code applies (sec 116). If the credit provider and supplier are sufficiently “linked” (sec 117), the credit provider may be jointly and severally liable with the supplier for damage suffered by the debtor: ¶14-210.

- (d) *Related insurance contracts*: Part 8. The Code applies to a “credit-related insurance contract” defined in sec 132 as insurance over the mortgaged property the subject of the credit contract, or consumer credit insurance. “Consumer credit insurance” is defined in Schedule 1 (¶17-050).⁴⁶

¶14-155 Consumer credit legislation: benefits to consumers and lenders. Benefits to consumers under the Consumer Credit Code include:

- (1) *Full disclosure*. The consumer is given information about the credit to be provided before — and after — entering the credit contract (eg ¶14-160—¶14-180).
- (2) *Assistance for reasonable cause*. If the consumer cannot make payments for “illness, unemployment or other reasonable cause”, the consumer can approach the credit provider to have the repayments under the contract altered or postponed, and if this request is refused, the consumer can then approach the court or tribunal to apply to have the contract varied (sec 66-69). The upper limit for this is \$125,000 (sec 66(3)) (¶14-230; ¶14-240).
- (3) *Default notice*. If the consumer is in default, the credit provider has to give notice of intended legal action. This can give the consumer a last chance to remedy the default (¶14-250).
- (4) *Access to justice*. The consumer has the right to have the credit contract examined by the court or tribunal to check if it is “unjust”. If it is found to be unjust, an order can be made to reduce the principal owing and/or credit charges under the contract, or even to declare the contract void (civil penalties: ¶14-290).

Benefits to lenders under the Consumer Credit Code include:

- (1) *Variations of contract*. Contracts can be varied to change payments and terms without having to incur the costs of formally rewriting the whole contract (¶14-230).
- (2) *Taxes*. Lenders can recover financial institutions duties and stamp duties in all contracts.
- (3) *Variation of interest rates*. Interest rates can be varied, especially with continuing credit contracts (¶14-230).

46. See generally Boxall, L, *Application of the Consumer Credit Code*, LIJ, Vol 70, No 6, p 35 (June 1996).

- (4) *Advertising opportunities.* Lenders can advertise more freely so long as the advertising is not misleading, deceptive or false (§7-250).
- (5) *Standardised systems.* Uniformity of documentation and systems allows for cost savings and increased staff effectiveness.

REGULATION UNDER CONSUMER CREDIT LEGISLATION _____

Advertising	¶14-160
Calculation of interest	¶14-170
The credit contract	¶14-180
Exclusion of legislation governing credit contracts	¶14-190
Implied conditions of the consumer credit contract	¶14-200
Liability of supplier and credit provider	¶14-210
Termination of related transactions	¶14-220
Variation of contract	¶14-230
Relief from harsh and unconscionable contracts	¶14-240
Enforcement by credit provider	¶14-250
Taking possession	¶14-260
Regulation of credit providers	¶14-270
Enforcement of credit law against credit providers	¶14-280
Civil penalties	¶14-290
Penal offences	¶14-300
Licensing offences	¶14-310

¶14-160 Advertising. The advertising of credit is governed by the *Trade Practices Act 1974* (Cth) (§7-230), the *Fair Trading Act* of each State/Territory and the common law. In addition, Part 9 (sec 140-146) of the Consumer Credit Code contains specific provisions on the advertising and marketing of credit:

- If the advertisement refers to the cost of credit, it must contain the annual percentage rate (sec 15(C): ¶14-170) and disclose any fees or charges (sec 140(3)). There must be no false or misleading representations (sec 144).⁴⁷ Breach of these sections has “civil effect” — the person who suffers loss can recover the amount of the loss from the person in breach (sec 140(5)).
- A credit provider’s representative must not harass a person or visit a person’s residence without prior arrangement, to induce a person to apply for credit (sec 145 and 146).⁴⁸

47. cf *Trade Practices Act 1974* (Cth) sec 52: ¶7-250; sec 53: ¶7-290.

48. cf *Trade Practices Act 1974* (Cth) sec 60: ¶7-460.

¶14-170 Calculation of interest. Before the *Credit Act* was passed, Australian consumers had difficulty comparing the available credit alternatives because different bases of disclosure were used, such as the effective rate or the flat rate.

The Molomby Committee recommended the adoption of an “ideal rate” of interest — easy to calculate and commercially and mathematically realistic — for disclosure in all consumer credit transactions.⁴⁹ This was the basis of the “annual percentage rate” in sec 38/Qld sec 40 of the former *Credit Act*.

The Consumer Credit Code deals with interest charges in Part 2 Div 3 (sec 25-28).⁵⁰ The interest rate to be disclosed in a credit contract is the “annual percentage rate” (sec 15(C)), and it is from this rate that the amount of interest (the “interest charge”) is determined. The method of calculation of the interest charge and the frequency of debiting the charge is to be disclosed in the contract (sec 15(D)), and this is to be contained in the statement of account (sec 32(E)).⁵¹

The maximum interest charge cannot exceed the amount calculated by applying the daily percentage rate (ie the annual percentage rate divided by 365) to the unpaid daily balance owed by the debtor (sec 26(1)). The unpaid daily balance is the difference between all credits and all debits to the debtor.

The maximum interest rate charge enables interest to be compounded because interest will be a debit like any other upon which interest can be charged (although there is a restriction under sec 27(1) against debiting interest until it has accrued).

The Regulations may prescribe a maximum annual percentage rate.

The Consumer Credit Code permits:

- Interest charges for a monthly, quarterly or half-yearly period (sec 26(2)).
- A higher rate of interest on default, but only on the amount in default while the default continues (sec 28). (Compare penalty rates: ¶6-490.)
- Contracts which prohibit the early payment of instalments.
- Fixed rate and variable rate interest rates.
- Variations of interest rates under sec 58(2)(a) and sec 59, although they may be annulled or reduced if the court considers them to be unconscionable (sec 72).

49. Molomby Report, *op cit*, para 4.5.16-4.5.18.

50. Lenders do not have to provide a “comparison rate” which allows a comparison of total fees, charges and the interest rate of the loan, although the use of a comparison rate is an option provided

for in the *Consumer Credit Regulation 1995* sec 12: sec 14(3), 140(3). See further Begg, S, *No truth in lending*, LIJ, Vol 70, No 6, p 32 (June 1996).

51. This is a “key requirement” in relation to continuing credit contracts: sec 100(2)(g); ¶14-180.

- Floating rates, such as a rate set by reference to the bank bill rate, but they are subject to specific disclosure requirements.

The Code prohibits:

- Interest calculated say monthly or quarterly in advance (ie based on the amount due at the commencement of the period).
- Rebating of interest under the “Rule of 78”.⁵²
- Payment of or debit of interest in advance.⁵³
- Predetermined interest charges (as in personal loans), although the regulations may permit them for a 12-month period.
- Early debiting of interest charges or requiring payment of interest in advance under credit contracts (including housing loan contracts) (sec 27).
- A credit provider not accepting early payments of required instalments unless they are actually prohibited under the contract (sec 24), subject to the right of the credit provider to charge a fee for a “prepayment of an amount under a credit contract” (so long as the early termination fee is not unconscionable: sec 72(c)).
- Credit contracts which provide for different annual percentage rates according to whether the debtor is in default under the contract.

Section 159 authorises regulations providing for tolerances within which interest, fees and other charges will be taken to comply with the Code — the interest charge is taken to be correct if it is less than the correct amount, or greater than the correct amount by not more than one part in one hundred of the correct amount. The Regulations may allow the rounding off of interest charges.

¶14-180 The credit contract. The Consumer Credit Code sets out the requirements for credit contracts:

- (1) Credit contracts (sec 12(a)), mortgages (sec 38(1)), guarantees (sec 50(1)) and consumer leases (sec 151(1)) must be in writing (cf ¶5-015; ¶5-030; ¶14-010). A goods mortgage need not be in writing if the credit provider had lawful possession of the goods before entering into the mortgage.

52. The Sch 1 formula of the former *Credit Act* gave the borrower a lower payout figure than the method — known as the Rule of 78 — used by the finance industry internationally to calculate the accrued credit charge owing on early payout of consumer loans. The Rule of 78 was held not to be equivalent to the Sch 1 formula in *Anderson v HFC Financial Services Ltd* [1988] VR 251; (1987) ASC ¶55-586,

noted (1987) 61 LIJ 950, (1988) 13 Legal SB 26, and millions of dollars have since been refunded to borrowers. The *Credit (Amendment) Act 1989* (Vic) validated the use of the Rule of 78 retrospectively for those contracts which had used it when refinancing or rolling over the contract.

53. There may be limited exceptions in the Regulations.

- (2) Credit contracts, guarantees and notices must be in plain English and comply with the printing requirements of the Regulations (sec 162(1)).⁵⁴ The contract document may have to comply with any form and expression set out in the Regulations (sec 16), and a copy given to the debtor, mortgagor or guarantor (sec 163).
- (3) The Code requires various disclosures so that consumers can consider their potential obligations.⁵⁵

In the case of a credit contract, the Code requires the credit provider to give the debtor a pre-contractual disclosure statement (sec 14) setting out the following disclosure “matters that must be in [the] contract document” under sec 15. Some of these requirements are “key requirements” which will attract the imposition of civil penalties if they are breached (sec 100: ¶14-280—¶14-290). The subsections of sec 15 are set out below:

- (A) the name of the “credit provider” (even if not the exact name: sec 158(7));
- (B) the amount of credit if ascertainable (sec 4(2)) — a “key requirement” in relation to credit contracts and, in part, to continuing credit contracts;
- (C) the annual percentage rate (sec 25: ¶14-170) — a key requirement in relation to credit contracts and continuing credit contracts;
- (D) the method of calculation of interest charges — a key requirement in relation to credit contracts and continuing credit contracts;
- (E) the total amount of interest charges payable — a key requirement in relation to credit contracts;
- (F) details of repayments;
- (G) “credit fees and charges” as defined in Sch 1(1) — a key requirement in relation to credit contracts and continuing credit contracts (cf sec 15(G)(c): ¶14-010);
- (H) changes affecting interest and credit fees and charges — a key requirement in relation to credit contracts and continuing credit contracts;
- (I) statements of account;
- (J) default rate (sec 25) — a key requirement in relation to credit contracts;
- (K) enforcement expenses;

54. The requirement of easy legibility and clear expression does not apply to mortgages. However, a mortgage could be reopened for this reason, especially under sec 70(2)(g) and sec 70(2)(i) if unjust (¶14-240).

55. In the words of Justice Brandeis, “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman”: Brandeis, LD, *Other People’s Money, and how the bankers use it*, 1914, p 92.

- (L) a statement of any mortgage or guarantee taken by the credit provider;
- (M) details of certain commission payable;
- (N) insurance financed by the contract — a key requirement in relation to credit contracts;
- (O) any other information or warning required by the Regulations.

A credit contract must not impose any fee or charge prohibited by or exceeding the amount allowed by the Code (sec 21).

There are currently two interpretations of what the credit provider must disclose to the borrower under the Consumer Credit Code:

- the amount agreed under the contract regulated by the consumer credit legislation to be lent and repaid in respect of stamp duty and other expenses;⁵⁶ or
 - the amount actually to be repaid, including insurance premiums, stamp duty and other charges under consumer credit and *other* legislation owing by the borrower.⁵⁷
- (4) The Code sets out specific requirements for related mortgages:
- The mortgage must be written and signed (sec 38, 164), must describe the property mortgaged (sec 40), must be secured only over the property of the debtor (third party mortgages are prohibited unless each mortgagor is a debtor or guarantor: sec 44) and cannot secure an amount which exceeds the liabilities of the debtor (sec 45).
 - A goods mortgage, however, need not be written if the credit provider had lawful possession of the goods before entering into the mortgage (sec 38(3)).
 - “All accounts” mortgages, which secure credit provided under future credit contracts or future guarantees, are permissible, but they are unenforceable unless the mortgagee has given the mortgagor a copy and has obtained written acceptance by the mortgagor (sec 43).
 - If the mortgage is a written document, a copy of the mortgage must be given to the mortgagor within 14 days (sec 39) or at the mortgagor’s request (sec 163).⁵⁸

56. As decided in *Custom Credit Corporation Ltd v Gray* [1992] 1 VR 540.

57. As decided in *ANZ Banking Group Ltd v Director General of Fair Trading* [1999] NSWCA 278, (1999) ASC ¶155-032, which did not follow *Gray’s case* (incorrect disclosure of “discharge

amount” and “refinancings”), discussed by Wilkin, J, *Truth in lending—disclosure of what?* (1999) 15(3) BLB 37 who supports the decision in *Gray’s case*.

58. eg Moore, D and Parker, R, *Mortgages and guarantees*, LIJ, Vol 70, No 6, p 38 (June 1996).

(5) The Code sets out specific requirements for guarantees:

- The guarantee must be written and signed by the guarantor (sec 50). It must be “easily legible” and “clearly expressed” (sec 162) or else it may be reopened as “unjust” if, for example, it fails the test of intelligibility (sec 70(2)(g): ¶14-240).
- The amounts secured by a guarantee are regulated:
 - extensions of guarantees are permitted if the credit provider has given the guarantor a copy of the contract document and has obtained written acceptance (sec 54);
 - a guarantee is void to the extent that it secures an amount that exceeds the liability of the debtor (sec 55);
 - the guarantor’s liabilities can be increased by written notice and acceptance in writing by the guarantor (sec 56); and
 - the credit provider’s enforcement expenses are limited to those reasonably incurred (sec 99).

(6) The Code sets out specific requirements for consumer leases:

- a consumer lease must be in writing (sec 151);
- a consumer lease must contain certain disclosures such as a description of the goods, the amount to be paid by the lessee and the number and amount of rental payments (sec 152); and
- the lessor must give the lessee a copy of the consumer lease and a statement explaining the rights and liabilities of the lessee unless the lessor has already given a copy to the lessee (sec 153).

Section 158 permits disclosure within the “tolerances and assumptions” to be allowed by the Regulations relating to pre-contractual statements, contract documents, mortgage documents, guarantees, notices or consumer leases.

¶14-190 Exclusion of legislation governing credit contracts.

Section 169 of the Consumer Credit Code provides that any attempt to contract out of the Code — such as its civil penalty provisions — is void. In addition to the attempt being void, it is an offence carrying a penalty of up to \$10,000.

¶14-200 Implied conditions of the consumer credit contract.

Consumer credit contracts contain the non-excludable implied conditions applicable to all consumer contracts from legislation such as the *Trade Practices Act* and the State/Territory Sale of Goods Acts. These are discussed at ¶7-035ff.⁵⁹

59. cf *Law Reform (Misrepresentation) Act 1977 (ACT)*, noted at ¶7-180; see further Cavanagh, SW, *Defective goods under*

hire-purchase: the effect of the new credit legislation (1985) 8 UNSWLJ 256.

The uniform hire-purchase legislation (§14-060) provided protection to hirers by imposing certain warranties and conditions into the hire-purchase contract. There are warranties that the goods are free from any encumbrances, and conditions on title, merchantable quality and fitness for purpose. Where the legislation is still in force, these continue to apply to second tier hire-purchase contracts which are unaffected by the consumer credit legislation, namely, what might be called non-consumer hire-purchase.

§14-210 Liability of supplier and credit provider. Hire-purchase (§14-060), consumer credit and trade practices legislation all impose legal liability in the event of breach of statutory implied conditions and for misrepresentation upon both the supplier *and* the “owner”/credit provider/financier. Section 6(3) (Tas) of the hire-purchase legislation gives the “owner” (financier) a right of indemnity against the dealer in the event of misrepresentation, although liability under sec 5 (Tas) (the implied conditions) attaches to the financier and/or dealer according to the actual operation of the implied condition.

Part 7 (Related sale contracts: sec 115-129) and sec 73 of the *Trade Practices Act 1974* (Cth)¹ have a similar effect. They provide that if a credit provider and a supplier are “linked” by a close commercial relationship (sec 117), the legislation imposes obligations on the credit provider which may result in the credit provider’s being “jointly and severally” liable² with the supplier for loss or damage suffered by the debtor (sec 119). Following this general proposition, the Code then sets about limiting the liability of the credit provider:

- proceedings are to be brought against both supplier and linked credit provider jointly (sec 120(2));
- the liability of the credit provider is not to exceed the sum of the amount financed, the amount of interest or damages, and the amount of costs awarded by the court or tribunal (sec 120(4)); and
- liability is first imposed on the supplier (sec 120(5)). This means that a judgment against a linked or related credit provider is enforceable only to the extent that the buyer has not received satisfaction from the supplier.

Section 118 provides that a linked supplier is deemed to be the credit provider’s agent in respect of a credit contract. Section 118 provides that if there is a “tied loan contract” or a “tied continuing credit contract” with respect to a sale contract (as defined in sec 117), the credit provider is liable

1. Also Consumer Credit Code sec 120(4); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 83(8)(b).

2. As with the liability of partners in tort (§10-240) and indorser and drawer of a

cheque (§16-340—§16-350); Consumer Credit Code sec 117(1); *Consumer Affairs and Fair Trading Act 1990* (NT) sec 83(14).

to the debtor for any misrepresentation, warranty or statement by the supplier. The credit provider is entitled to indemnity by the supplier under sec 118(2).

¶14-220 Termination of related transactions. Parties to a contract for the sale of goods or services have the right to rescind or discharge the contract for various reasons both at common law and under statute. This right would be of little practical value in a consumer credit situation if the contract for credit with the credit provider remained on foot.

Purchase “subject to finance”: sec 124. A purchaser has the right to terminate a sale contract for goods or services (not real property) which is conditional on obtaining credit if the purchaser has:

- made known to the supplier that credit is required in order to pay,
- made “reasonable endeavours” to obtain credit, and
- failed to obtain credit on reasonable terms (sec 124).

As “services” is defined to include rights in relation to real property (Sch 1(1)), sec 124 applies to the *Masters v Cameron* situation of a purchase “subject to finance” (¶5-250) to allow a purchaser to avoid what would otherwise be a legally binding contract.

Termination of tied credit contract: sec 125. Section 125 of the Consumer Credit Code allows a debtor to terminate the credit contract in the case of a tied loan contract, or entitles the debtor to be credited with the amount of credit and the interest charges. Termination must be in writing (sec 127).

The Consumer Credit Code also sets out the liabilities of the consumer, the supplier and the linked credit provider which essentially are sorted out as follows:

- The goods are to be redelivered to the supplier by either the consumer or the credit provider (if the goods are in their possession, and if there is nothing owing to the credit provider by the supplier).
- The credit provider and the supplier are liable to the consumer to refund moneys paid.

Any disputes over rescission can be dealt with by the court on the application of any interested party (sec 128).

¶14-230 Variation of contract. Circumstances may change during the life of the credit contract, so the Code provides for (1) unilateral change and (2) change by agreement.

(1) Unilateral changes by the credit provider — Part 4 Div 1 (sec 58-64).

Interest rate changes. The credit provider is to give written notice of some interest rate changes not later than the day on which the new rate takes effect (sec 59(1)) or notice by publication in a newspaper circulating in the jurisdiction (sec 59(2)). Some unilateral changes are excluded by sec 58(2) (where specified in the contract) and sec 59(5) (dealing with rate reductions).

Repayment changes. Section 60 states that a maximum of 20 days' notice is required for increases in the amount, frequency or time for payment, or a change in the method of calculation of, instalments or minimum repayments under a credit contract.

Changes in credit fees and charges. Increases in credit fees and charges need 20 days' written notice before the change (sec 61).

Changes to credit limits, etc in continuing credit contracts. The debtor must be notified of these changes in writing (sec 62).

Other unilateral changes by credit provider. At least 20 days' notice is required under sec 63 for other unilateral changes to the terms of the contract.

Prohibited increases in liabilities. Prohibited increases in liabilities if the annual percentage rate is currently fixed: sec 64.

- (2) Changes by agreement of the parties — Part 4 Div 2 (sec 65). Section 65 requires that an increase in the amount of credit by agreement of the debtor and creditor must be confirmed in writing not later than 30 days after the date of the agreement.

In addition to Part 4 Div 2, sec 37 of the Code provides that a change, deferral, waiver or postponement under an existing credit contract (including an existing consumer lease) is not to be treated as a new contract. Changes can also include modification of terms, extension of time to pay and postponement of enforcement proceedings (sec 86).

¶14-240 Relief from harsh and unconscionable contracts.

Part 4 Division 3 of the Consumer Credit Code (sec 70-74) provides for changes to credit contracts on the grounds of hardship and unjust transactions. The debtor, mortgagor, or guarantor can apply to the court or tribunal to determine that the credit contract, mortgage or guarantee (respectively) is "unjust" and to reopen the transaction that gave rise to it. "Unjust" is defined to include "unconscionable, harsh or oppressive" (sec 70(7)) — in other words, this definition is not exhaustive. This law targets the oppressive consequences of unjust dealings which offend against community standards of business morality.³

Under sec 66, on the basis of a hardship application of the debtor, a court may change the terms of the contract by:

- (a) extending the period of the contract and reducing the amount of each payment;
- (b) postponing payments during a specified period;
- (c) extending the contract and postponing payments during the extension (sec 66(2)).⁴

3. Bingham, P and Low, R, *Re-opening unjust contracts*, LIJ, Vol 70, No 6, p 42 (June 1996).

4. eg Kaspen, A and Bingham, P, *Hardship variations under the Consumer Credit Code* (1999) 73(3) LIJ 68.

To determine whether a term of a credit contract, mortgage or guarantee is unjust, the Code directs the court or tribunal to have regard to the “public interest and to all the circumstances of the case”, including the “shopping list” of tests set out in sec 70(2)(a) to sec 70(2)(o).

These tests overlap those in the unconscionability provisions of the *Trade Practices Act 1974* (Cth) (sec 51AB(2): ¶5-755 and sec 51AC(3): ¶5-756), the Fair Trading Acts, and the *Contracts Review Act 1980* (NSW) (¶5-760).⁵ *West's case* (1986: ¶5-760), the leading case on the *Contracts Review Act*, is therefore equally applicable to the interpretation of the Consumer Credit Code.

Examples of harsh and unconscionable conduct include a lender taking advantage of a debtor who is in a desperate financial position, or who is not independently advised or who is inexperienced in matters of credit. A high interest rate alone is insufficient to show unconscionable conduct.⁶

— *Case example under the former Credit Act* —

For some 18 years P and her family had purchased goods in the comfort of her own home from D Trading Company Pty Ltd. For the last eight years, the company's representative was D, who had become a regular visitor, and the P family dealt with him in a trusting and unquestioning manner. As a friendly gesture, and as part of the service, D provided loans with interest to help finance the goods D supplied. Reassessment of these loans, and the realisation that the interest charge was over the statutory maximum of 48% (¶14-170), led to successful defensive action by P. The Victorian Credit Tribunal found the contracts unenforceable under the equivalent of sec 70(2)(n) (finding the interest rate to exceed 80% — P's solicitor's calculation was over 400%) and ordered that any balance due not be paid. Further, the contracts were found to be “unjust” under the equivalent of sec 70 — there was material inequality of bargaining power of the parties, and no independent legal advice; the contract was not able to be negotiated, its terms were not explained, it was not understood by P, and the annual percentage interest rate was not disclosed. Accordingly the contracts were reopened under the equivalent of sec 71(b); reinforcing the order under the equivalent of sec 70(2)(n), the existing liabilities of P were expunged and the outstanding balances discharged with costs.

— *Bava v Carvill Trading Company Pty Ltd*⁷ —

¶14-250 Enforcement by credit provider. The uniform hire-purchase legislation (sec 13-18) requires that the credit provider give a consumer in default notice before enforcing its rights by calling up the balance of principal, taking court proceedings or exercising security rights. The Acts

5. Similar provisions exist in the uniform hire-purchase legislation: *Hire-Purchase Act 1959* (Vic) sec 24; *Hire Purchase Act 1959* (Qld) sec 28; *Consumer Transactions Act 1972* (SA) sec 22; *Hire-Purchase Act 1959* (WA) sec 24; 1959 (Tas) sec 33.

6. *Planet Securities Unit Trust v Dalrymple* [1999] QSC 204 at [52]; ¶5-730.

7. (1987) ASC ¶55-552; see, eg, *Espiritu v Australian Guarantee Corporation Ltd* (1997) ASC ¶155-004.

lay down procedural formalities designed to give a consumer in default a period to get organised.

Part 5 of the Consumer Credit Code (sec 75-99), entitled “Ending and enforcing credit contracts, mortgages and guarantees”, sets out similar formalities for enforcement by the credit provider.

Section 80 sets out the requirements to be met before the credit provider can exercise its rights against a defaulting debtor or a defaulting mortgagor:

- The debtor is in default.
- The credit provider serves on the debtor (and any guarantor) a “default notice” which gives at least 30 days in which to remedy the default (sec 80(1)). A default notice is not required if (sec 80(4)):
 - the debtor or mortgagor fraudulently induced the credit provider to enter into the transaction; or
 - reasonable attempts were made to find the debtor or mortgagor; or
 - the creditor provider has court or tribunal authorisation; or
 - urgent action is necessary to protect the mortgaged property.
- Any further default within this specified period may be subject to enforcement proceedings without further notice (sec 80(3)).
- The debtor fails to remedy the default within the time specified after service of the notice.
- The default notice can be combined with a default notice under any other law dealing with default, such as real property law (sec 161(2)).⁸

During this time, the debtor may be able to gain some time to organise repayments either by seeking from the credit provider a variation of the credit contract (under Code sec 58-61, 65, 66, 69) or by negotiating with the credit provider for a postponement of enforcement proceedings under Part 5 Div 3 (sec 86-89, if under \$125,000): ¶14-230.

If the debtor fails to remedy the default or to gain a variation or postponement, the credit provider can take action, but is only entitled to recover from the debtor the amount due on payout as set out in sec 75 of the Code. This is the principal and interest, and all fees and charges, reasonable enforcement expenses and early termination charges, if provided for in the contract. (The same procedure applies under goods mortgages: sec 94, 96-98.)

Acceleration clause. An acceleration clause provides that on the happening of a particular event, the credit provider can accelerate payment of the outstanding balance of the credit contract or mortgage (sec 84). A default notice must have been given under sec 80 (sec 85(1)), unless certain exceptions are fulfilled such as the credit provider suspecting fraud (sec 85(2)). In the case of a

8. eg *Real Property Act 1900* (NSW) sec 57.

mortgage over goods, sec 96, dealing with the sale of goods by the credit provider, provides its own acceleration clause.

¶14-260 Taking possession. The Consumer Credit Code preserves the traditional right of the secured lender to repossess the security in the event of default, with the reminder that credit providers exercising their power of sale of mortgaged goods owe a duty of care to the borrower (Part 5 Div 4: sec 90-98).⁹

Unauthorised repossession could expose the credit provider to legal action for the tort of conversion (¶14-020; ¶15-130)¹⁰ and/or to a claim for compensation (and perhaps a penalty) if the notice requirements of the enforcement sections are not complied with.

— *Case example* —

D owed money to P, secured by a bill of sale. Acting on P's instructions, bailiffs seized the goods and they were sold. The seizure and sale were in breach of the legislation, and P was ordered to pay damages to D.

— *Spence v Roberts*¹¹ —

Prior informed consent of the debtor, or an order of a court or tribunal, is required before the credit provider (and its agents) can enter *residential* premises to repossess goods (sec 91, 92, 93).

Certain restrictions are imposed by the Code essentially to ensure that the debtor's "equity" in the property is protected. Part 5, entitled "Ending and enforcing credit contracts, mortgages and guarantees" (sec 75-99), contains the provisions on repossession.

After the credit provider has taken possession of the mortgaged goods:

- the credit provider must give the mortgagor a written notice containing the estimated value of the goods and the enforcement expenses to date, and must return the goods if this amount is paid within 21 days (sec 94(1));
- goods repossessed or surrendered voluntarily can be sold by the credit

9. Sec 80(6) also provides a reminder that the law of real property mortgages is not affected by the Code: ¶13-045.

10. eg under the former *Credit Act* in *Martin v Australian Guarantee Corporation Ltd* (1988) 50 SASR 222; (1989) ASC ¶55-698, borrowers initially succeeded against their lenders for conversion for seizure of the mortgaged prime mover and trailer on the grounds that their credit contract and consumer mortgage were void. On appeal, the two documents headed "Consumer Mortgage" and "Credit Contract" were held to represent a bill of sale (¶13-070—

¶13-140). The lender was therefore entitled to repossess and to sell the goods under the power granted by *Bills of Sale Act 1886* (SA) sec 11: Bingham, P, *How to get out of a repossession* (1992) 66 LIJ 891; Lanyon, E, *Enforcement*, LIJ, Vol 70, No 6, p 45 (June 1996).

11. (1995) ASC ¶56-312. The bill of sale was a consumer mortgage, regulated by the *Consumer Transactions Act 1972* (SA). D had failed to comply with sec 27 and 28 of the South Australian Act by failing to give appropriate notice.

provider under its power of sale (resembling that of a mortgagee: ¶13-045) so long as the “best price reasonably obtainable” (sec 79(1), 96(1), 98(1)) is aimed for. Failure by the credit provider to also look after the interests of the debtor — such as selling by auction for less than half its retail price a vehicle surrendered voluntarily — can expose the credit provider to the risk of having to compensate the debtor for the difference between the sale price and the actual value;¹²

- enforcement expenses are limited by sec 99(1) to “those reasonably incurred” by the credit provider. Default charges are therefore limited by the Code.

The Code contains at least one important provision on the subject of repossession. Section 83 provides that a credit provider cannot repossess mortgaged goods without the consent of the court or tribunal if the amount currently owing is less than 25% of the amount of credit provided under the contract or \$10,000, whichever is the lesser. The credit provider will only be able to repossess with an order of the court or tribunal or by a request from the debtor for the mortgagee to exercise its power of sale under sec 78. The notice requirements of sec 80, noted at ¶14-250, will also have to be complied with as one of the restrictions upon repossession.

If entitled to possession of the mortgaged goods, the credit provider may apply to the court under sec 93 for an order for possession of the goods, whether or not the mortgagor or the person in possession has refused to deliver them (after receiving notice under sec 80).

Part 5 Div 3 (sec 86-89), which provides for postponement of enforcement proceedings, does not apply to repossession as it is limited to the period of the default notice. If goods have been repossessed then it follows that the period of the default notice has expired — it would no longer be open to the debtor to seek a postponement under these sections (although informal negotiations can take place at any time).¹³

¶14-270 Regulation of credit providers. Under the Standing Committee of Consumer Affairs Ministers (SCOCAM) 1993 agreement giving rise to the Consumer Credit Code (¶14-010), regulation of credit providers — by registration or negative licensing¹⁴ — is not required to be uniform and is to be covered by separate State/Territory legislation.¹⁵

12. As in *Harrison v Mercantile Credits Ltd* (1987) ASC ¶155-537 under the former *Credit Act 1984* (Vic).

13. eg *Anseline v General Motors Acceptance Corporation* (1998) ASC ¶155-020.

14. As in NSW, Qld, SA and the NT: negative licensing means either automatic registration or no requirement for registration at all, subject to deregistration

or exclusion from the industry (respectively). Only the former *Credit Act 1987* (Qld) provided for negative licensing.

15. eg *Credit (Administration) Act 1984* (Vic), as amended by the *Consumer Credit (Victoria) Act 1995* (Vic); *Credit Administration Act 1995* (SA).

The related legislation regulates the provision of credit to consumers by controlling the type of person in the industry. Licence applications go to the licensing authority, which may receive objections from the Government Consumer Agency and consumer groups representing the public interest ("or any other person": cf ¶8-810). Applications under the *Credit Act* were sometimes hotly contested. The onus was on the licence applicant to show full compliance with the credit legislation and a commitment to perform duties under the legislation "efficiently, honestly and fairly". This was illustrated by such matters as substantial expenditure towards staff training, constant review of manuals, forms, documents and procedures and the applicant's attitude to dealing with consumer complaints.

— *Case example* —

After 14 months of hearings instigated by the Victorian Director of Consumer Affairs and the Consumer Credit Legal Service (on behalf of 57 clients) who objected to its credit provider's licence application, HFC, a multinational finance company operating in five States, was initially denied a licence in Victoria by the Credit Licensing Authority on 12 September 1989 on the basis that it could not be trusted to operate honestly, fairly or efficiently in the short term. "[G]rossly improper" practices (in the words of the Authority's chairman) included its methods of collecting repayments, its requirement of compulsory insurance (insurance is optional under credit law), its failure to refund insurance rebates after loans had expired, its failure to inform prospective borrowers of the extent of their repayments and its conscious failure to train staff.

— *HFC Financial Services Ltd*¹⁶ —

Conditions may be imposed upon the credit provider's licence by the Tribunal, such as requiring the functions of an individual debt collector and at-home salesperson to be kept separate, or requiring that each customer be provided with a full statement of account, say every three months.

Not all credit providers have to be licensed under the legislation, and licensing is required only where "providing credit" is by way of a regulated contract or a regulated mortgage. Credit advisers do not have to be licensed.

The following are exempted from licensing under the Consumer Credit Code because they are regulated under their own legislation but they must comply with the other requirements of the Code: the Crown, a public or local authority, banks, insurance companies, pawnbrokers, friendly societies, building societies, co-operative societies, credit unions, pastoral finance companies and any person authorised by legislation to lend money.

¶14-280 Enforcement of credit law against credit providers.

Enforcement of the Consumer Credit Code is by means of civil penalties (¶14-290), penal sanctions (¶14-300) and/or licensing sanctions (¶14-310).

16. Credit Licensing Authority, 12 September 1989, unreported: see *The Age*, 13 September 1989. Further proceedings: *HFC Financial Services Ltd v Director*

of Consumer Affairs (1990) ASC ¶55-959. On new application, licence granted with conditions.

The Code provides for enforcement by the parties to the contract, and by the “Government Consumer Agency” — the consumer affairs authority of each State and Territory.

For example, the Agency, as well as a party to a credit contract or a guarantor, can apply to the court or tribunal for an order where a “key requirement” listed in sec 100 (see also ¶14-180) has been breached (sec 101(1)). If a civil penalty is imposed, it is to be paid to a special fund, or to the Agency (sec 106).

In addition, sec 111 gives the Agency a public interest function to become a party to any proceedings of a debtor, guarantor or credit provider under Part 6 Div 1 (sec 100-113) of the Code.

As part of its enforcement process, the Agency has the traditional powers of a consumer affairs department including the power to enter premises and to inspect and take copies of books, records and so on.

¶14-290 Civil penalties. The purpose of civil penalties is to encourage compliance with and enforcement of the Consumer Credit Code by “self regulation” as an alternative to the government allocating public moneys to fund a government administrative bureaucracy.

Part 6 of the Code is entitled “Civil penalties for defaults of credit providers” (sec 100-114). Section 100 sets out a number of “key requirements” for credit contracts and for continuing credit contracts concerning the matters that must be in the contract (see ¶14-180).

If a key requirement is breached, a party to a credit contract, a guarantor or the Government Consumer Agency may apply to the court or tribunal for a civil penalty (sec 101-102):

- if the application is made by the debtor or guarantor, the maximum civil penalty is the interest charges payable under the contract (sec 103) or the actual loss suffered by the debtor or guarantor for breach of a key requirement (sec 107);
- if the application is made by the credit provider or by the Government Consumer Agency, the civil penalty is capped at \$500,000 nationally for all contraventions of the same key requirement (sec 105(1)).

Section 102 of the Code sets out the procedure for applications to the court or tribunal to determine whether a credit provider has breached a key requirement. Matters to be taken into account include the “prudential standing” of the credit provider (sec 102(3)) and the credit provider’s conduct, whether or not the contravention was deliberate, the loss suffered by the debtor and the credit provider’s compliance system (sec 102(4)).

— *Case examples* —

The court confirmed that the applicant had breached sec 15(E) of the Code (¶14-180) in the case of 1,030 consumer credit contracts, but imposed no civil penalty under sec 100 on the basis that:

- the applicant had tried to implement administrative systems to ensure compliance;
- the breaches were inadvertent;
- no debtor suffered loss or detriment as a result of the breaches;
- the applicant had acted promptly to correct the problem after it had become aware of the breaches; and
- the applicant had incurred costs of over \$100,000 in respect of this case.

_____ *Suncorp-Metway Ltd v Director-General, Department of Equity and Fair Trading*¹⁷ —

“*Buyer’s Edge*”. A civil penalty of \$250,000 was imposed on a finance company for about 11,900 contracts which breached key requirements (¶14-180) of the Consumer Credit Code.

_____ *GE Capital Finance Australia v Various Debtors*¹⁸ —

A penalty of \$5 per contract was imposed on a small community-based credit union with some 1,200 members for 447 contracts which breached key requirements (¶14-180) of the Consumer Credit Code. Although small, the penalty was designed as a reminder to other credit providers of their obligations under the Code.

_____ *Re Polish Community Credit Union Ltd*¹⁹ —

Under sec 106, the civil penalty must be paid by the credit provider to the Government Consumer Agency or to a statutory fund. For example, the New South Wales Financial Counselling Trust Fund was set up in 1992 to alleviate credit over-commitments by consumers and to advance public education in the area of personal finances.

Under the former *Credit Act*, there were 66 “triggers” leading to automatic loss of credit charges for certain breaches subject to the credit provider’s right to apply for reinstatement. The Code has reduced the triggers to the “key requirements” of the credit provider set out in sec 100 (¶14-180). Non-compliance no longer triggers an automatic penalty, because application to the court or tribunal must be made by a party to the credit contract, a guarantor or the Government Consumer Agency.

The *Encyclopaedia Britannica case* and the *Westpac case*, decided under the previous *Credit Act*, show how the credit provider in breach automatically lost its credit charges and had to apply to the court or tribunal for reinstatement under former *Credit Act* sec 85/Qld sec 86.

— *Case example* —

Encyclopaedia Britannica (Australia) Inc (hereafter “E”) had applied for a credit provider’s licence in New South Wales in February 1985, but even after its Vice President in Charge of Operations had attended seminars in

17. (1999) ASC ¶155-027.

19. (2000) ASC ¶155-037.

18. (2000) ASC ¶155-036.

1984 on the requirements of the then forthcoming Victorian credit laws, E failed to follow up in Victoria, apparently believing licensing to be a mere technicality and that an exemption from the Minister of Consumer Affairs would be readily available. E continued to trade in Victoria unlicensed, and on the final realisation in February 1986 that its contracts for credit were unenforceable, and that E faced the possibility of civil penalties as well, E finally lodged a licence application in May 1986. To overcome what was described as an embarrassing difficulty — the statutory non-enforceability of its contracts — E applied to the Credit Tribunal under sec 85 (for an order reducing its loss for contravention of the credit legislation) to restore in full the liability of about 1,000 debtors from nil (as it then stood) to the amount of the debtors' liability then standing at about \$2.2m. As recognised by the Referee, "[a]ny order that the Tribunal may make is a gain because under the legislation [E] is not entitled to any amounts from the debtors and is required to repay any amount that it has received during the period that [E] was unlicensed." However, in light of various factors (that E's documentation was clear and simple and that debtors were basically unconcerned whether or not E was licensed) and reasonableness (in the words of E's counsel, "not even drug smugglers are treated this harshly" if the \$2.2m liability were not substantially reinstated), an order was made in favour of E under sec 85 to increase the liability of the debtors from nil to 95% in the period 1 June 1985 to 21 March 1986 (the date of E's realisation of the need for a licence). During the period of E's procrastination, liability was reinstated on a sliding scale from 92% down to 21.5%, and in the period after the lodging of E's licence application, nil increase of debtor liability was ordered.

— *Encyclopaedia Britannica (Australia) Inc v Various debtors*²⁰ —

The civil remedies had a penal aspect, and the penalty to be imposed by the Tribunal in the exercise of its discretion should be proportionate to the conduct of the credit provider and debtor and any detriment sustained by the debtor".

— *Case example* —

Westpac consumer credit contracts contained five errors concerning commission charge non-disclosure, name of insurer, discharge amount and date of signature. It was estimated that 84,277 contracts were affected by the errors with credit charges of \$178m at risk. By mediation, the parties (Westpac, the Consumer Credit Legal Service and the Victorian Ministry of Consumer Affairs) agreed that Westpac need not contact all debtors

20. (1987) ASC ¶55-532, upheld on appeal in *Encyclopaedia Britannica (Australia) Inc v Director of Consumer Affairs* [1988] VR 904; (1988) ASC ¶55-636; *Custom Credit Corporation Ltd (in liq) v Various Debtors* (1999) ASC ¶155-033 (192,628 finance contracts entered between 1984 and 1992 in breach of the former Credit Acts putting credit charges of \$374m at

risk; debtors' liabilities reinstated, with the finance company paying (approx) \$515,000 to the NSW Financial Counselling Trust Fund; \$50,000 into the ACT Trust Fund and \$275,000 into the Victorian Trust Fund). See further Duggan, T and Niven, D, *Civil penalty provisions*, LIJ, Vol 70, No 6, p 47 (June 1996).

personally, but that it could notify them by advertisement of their right to a refund if their loan contract contained the errors.

_____ *Westpac Banking Corporation v Various Debtors*²¹ —

¶14-300 Penal offences. The Consumer Credit Code imposes various requirements, breaches of which are punishable summarily by a fine (sec 180), mostly on the application of the Government Consumer Agency. The Code contains over 50 penal offences, punishable by a penalty ranging from 30 penalty units to 100 penalty units. A penalty unit is defined in sec 179 as \$100. In Western Australia, fines are set out in dollars (¶14-080).

These penalties are in contrast to the maximum civil penalty of \$500,000 for breach of the key disclosure requirements (sec 105(1): ¶14-290).

Section 170 of the Code provides that a credit contract, mortgage or guarantee is not illegal, void or unenforceable because of breach of the Code, unless the Code so provides. This confirms the position at common law — that it is a matter of interpretation whether the legality of a contract made in breach would be affected. This would normally be classed as “incidental illegality”, and it would not affect the enforceability of the contract between the parties: ¶15-825.

¶14-310 Licensing offences. The licensing provisions of the State and Territory law give the relevant authority (¶14-270) the power to revoke, suspend, cancel and to take any other disciplinary action. This power to penalise is clearly an enforcement function.

The court or tribunal (¶17-730) can take disciplinary action if a credit provider has acted unlawfully, improperly, negligently, unfairly or contrary to an assurance to the Government Consumer Agency, and it can reprimand, impose a fine or prohibit the defendant from carrying on business of a credit provider. Disciplinary proceedings can be commenced by the Consumer Agency or equivalent or “any other person”²² lodging an application with the Court or Tribunal concerning a credit provider. This gives standing to bodies such as the community legal services and welfare agencies to take action against any credit provider, or to object to licence renewal for such matters as a credit provider’s failing to obtain satisfactory bids for repossessed vehicles (leaving debtors with more to pay than otherwise necessary) or giving enticing credit limit extensions to low income earners with inadequate means to pay for such credit.

21. (1993) ASC ¶56-202. The cost to Westpac to identify and contact all debtors might have been a greater penalty than any refund. Avco lost 10% of its credit charges for failure to disclose commission charges: an appeal concerning the penalty was unanimously dismissed. *Avco Financial Services Ltd v Abschinski*; *Avco Financial*

Services Ltd v Adonis (1994) ASC ¶56-256.

22. eg *Consumer Credit (Victoria) Act 1995* (Vic) sec 28; *Credit Administration Act 1995* (SA) sec 6; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 225C-225F.

OWNERSHIP OF MOTOR VEHICLES _____

Motor vehicle ownership: the issues	¶14-320
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¶14-320 Motor vehicle ownership: the issues. Some of the remedies to protect purchasers of motor vehicles have already been discussed in Chapter 7. A new approach to motor vehicle ownership problems is reflected in the operation of vehicle encumbrance registers or title security systems in all State and Territory jurisdictions. The idea of a vehicles securities register, pioneered in Victoria in 1981, came into operation in 1984, and was re-enacted in 1987.²³ A comparable register was established in Tasmania in 1984; in New South Wales, Queensland and South Australia (1986); in Western Australia (1987), in the Northern Territory (1989) and in the ACT (1990).²⁴

The effect of establishing registers is that financiers can give public notice of their interests in motor vehicles, and prospective purchasers are provided with a means of checking whether particular vehicles are encumbered. A person buying a vehicle in good faith and for value without notice of an encumbrance should acquire the vehicle free from encumbrance. The legislation contains provisions to expand the registers in the future to include other identifiable goods. For example, the New South Wales register was expanded in April 1996 to cover boats.

Consequently, a financier who does not register an interest in a vehicle runs the risk of losing that interest as against the bona fide purchaser. The financier's rights against the original debtor are not interfered with by the legislation. Thus, the overall impact of the legislation is to withdraw the protected status of credit providers and to therefore shift the loss from the innocent third party.

In summary, the problem which could have faced an unwary purchaser was no more than one practical application of the *nemo dat* rule (noted at ¶3-270; ¶7-020); namely, that if a vehicle was sold to C which did not really belong to the seller B, but in fact was "owned" by credit provider A, or was even stolen, who now owned the vehicle — the "new owner" C or the "true owner" A?

23. *Chattel Securities Act 1987* (Vic).

24. *Motor Vehicles Securities Act 1984* (Tas); *Registration of Interests in Goods Act 1986* (NSW); *Motor Vehicles Securities Act 1986* (Qld) (detailed in MacGillivray, L, *Motor Vehicles Securities Act 1986*

(1986) 16 QLSJ 247); *Goods Securities Act 1986* (SA); *Chattel Securities Act 1987* (WA); *Registration of Interests in Motor Vehicles and Other Goods Act 1989* (NT); *Registration of Interests in Goods Act 1990* (ACT).

This led to the practical issue of which of two innocent parties — the true owner A (often the hire-purchase company) or the innocent purchaser C — was to lose the car. Under the *nemo dat* rule, ownership never left the true owner and the innocent purchaser would therefore lose the car. To this rule there are a number of exceptions under the sale of goods legislation operating in all States and Territories allowing for transfer of title by a non-owner: ¶7-020. Certainly the innocent purchaser C might be able to sue the vendor for breach of contract (such as breach of the implied condition under the *Trade Practices Act*, and under the sale of goods legislation, contained in the contract to the effect that the vendor had the right to sell the car (¶7-040—¶7-050)), but as has often happened in these circumstances, the consumer's money and the vendor may be nowhere to be found.

The other problem facing an unwary purchaser is the right of the credit provider to repossess the vehicle. If the debtor sells the vehicle, the purchaser who wishes to keep the vehicle and avoid repossession will be liable for the repayments.

¶14-340 The motor vehicles securities registers. The various motor vehicles securities registers²⁵ which have been set up in all jurisdictions (¶14-320) provide for the registration of those vehicles which are registered under the motor traffic legislation.²⁶ Some registers include trailers, caravans, semi-trailers, small boats and farm machinery.

The motor vehicles securities registers provide for:²⁷

- (1) An asset-indexed system of registration.²⁸
- (2) The registration of a "security interest" for the payment of a debt (¶13-160) as defined in, eg, sec 3 of the Western Australian Act:

"'security interest' means an interest in or a power over goods (whether arising by or pursuant to an instrument or transaction) which secures payment of a debt or other pecuniary obligation or the performance of any other obligation and includes any interest in or power over the goods of a lessor, owner or other supplier of goods, but does not include a possessory lien or pledge".

Following recent amendment, the legislation now provides for registration by holders of possessory liens (including repairers), pledges and the holder of any encumbrance on an unregistered vehicle.

25. Vic: Vehicles Securities Register; NSW: Register of Encumbered Vehicles ("REVs", expanded in 1990 to the ACT and the NT with the passing of parallel ACT and NT legislation thereby covering one-third of the encumbered vehicles in Australia); Tas: Motor Vehicles Securities Register; Qld: Register of Encumbered Vehicles; SA: Register of Security Interests; WA: the register. Most

jurisdictions are now participants in the National Vehicle Security Register — a national scheme of security interests.

26. eg *Road Traffic Act 1974* (WA); *Traffic Act 1925* (Tas).

27. See, eg, MacGillivray, *op cit*, pp 247-248.

28. Compared to the less desirable name-indexed system of the earlier bills of sale legislation: ¶13-070—¶13-140.

- (3) Public search of the register by quoting vehicle particulars such as registration number, engine number and chassis number²⁹ (by phone or by on-line access) and the issue of a legally binding certificate (for a nominal fee) containing particulars of entries in the register and to which legal liability (for potential negligence) will more readily apply (¶4-260).³⁰ Intending purchasers or financiers of a vehicle are entitled to, and should, search the register before proceeding (¶14-360).
- (4) A fair and easily understood system of priorities (¶13-160 (in Victoria and Western Australia); ¶14-360—¶14-370).
- (5) Extinguishing of an unregistered security interest where a person purchases goods in good faith, for value and without notice of the interest (¶13-160; ¶14-360).
- (6) Compensation to the holder of a registered security interest who has suffered a loss because a purchaser has for some reason acquired the goods freed and discharged from the interest. Compensation is also available for the holder of a registrable interest which has not been registered if there is a reasonable excuse for that interest not being registered (¶14-380).

The National Vehicle Security Register legislation is undergoing amendment to ensure (among other things) that:³¹

- interests registrable under the legislation are not extinguished by the sale of the goods to a purchaser who then leases, hires or sells the goods to a person who does not act in good faith and who has notice of the interest when the purchase price is paid;
- registrable interests are ranked in priority by providing that registered interests have priority over unregistered interests, and registered interests rank in priority of registration;
- a repairer's lien has priority over any registrable interest (¶13-270);
- the extinguishment provisions apply only when the goods are in the jurisdiction at the time of the purchase that extinguishes the interest; and
- a person has "notice" if put upon inquiry.

29. eg in NSW, the "prime identifier" of a motor vehicle to be quoted is the "vehicle identification number" (VIN) for vehicles manufactured after 1989 — otherwise it is the chassis number — as well as registration number and engine number.

30. Query whether the decision in *L Shaddock & Associates Pty Ltd v Parramatta City Council* (1981) 150 CLR 225; (1981) 55 ALJR 713 may impose greater accountability for advice given in all forms (eg by telephone): ¶4-260.

31. Based on the Report of the National Vehicle Security Interest Register Project by Professor A Duggan, established by the Ministerial Council on Consumer Affairs, 1997, noted, eg, *CCH Australian Consumer Credit Law Reporter* ¶150-561. See, eg, *Registration of Interests in Goods Amendment Act 1999* (NSW); *Chattel Securities (Amendment) Act 1998* (Vic).

¶14-350 Voluntary registration. Registration of a security interest is voluntary and, in contrast to registration schemes in some other countries, there is no obligation on security holders to register their security interests. The effectiveness of the registration system depends upon voluntary registration: a person *may* make an application, in the words of the relevant legislation. No penalty is imposed for a failure to register. However, priority is given by the legislation to a registered security interest over an unregistered security interest. To this extent, the legislation amends the bills of sale legislation operating in each State (¶13-070— ¶13-140), so that a registered security interest will take priority over a registered or an unregistered bill of sale. Unlike the bills of sale legislation, a registered security interest which is an unregistered bill of sale is not void against the Official Receiver. Credit providers are actively encouraged by the legislation to register their security interest in motor vehicles. In turn, prospective purchasers are saved the additional cost and time of having to search other registers covering bills of sale or company charges. Priorities between competing security interests are discussed at ¶13-160 (Victoria and Western Australia); ¶14-370.

¶14-360 Purchaser's constructive notice. All jurisdictions provide for the registration of security interests in motor vehicles so that a prospective purchaser can search the Register to check whether the vehicle is encumbered by a security (or finance) interest. If the Register records a security interest, the purchaser should contact the financier and obtain either details of the payout (if the loan is current) or confirmation in writing that the loan is paid out. A purchaser's failure to search the register is no defence against the claim of a security holder, and such failure precludes any claim for compensation. The legislation describes the circumstances in which a person is deemed to have notice of a security interest in goods:³²

- (a) the person had actual notice of a security interest or other interest entered on the register, or
- (b) had been put upon inquiry as to such interest and had failed to inquire further.

The effect of non-registration of a security interest in a motor vehicle is that the bona fide purchaser will take free from the security interest:³³

"14(1) Extinguishing of security interest. Where a person is the holder of a security interest in a motor vehicle or trailer and a purchaser purchases an interest in that motor vehicle or trailer for value in good faith and without notice of a security

32. The NSW legislation has no specific provision dealing with notice because of the effect of the *Conveyancing Act 1919* (NSW) sec 164 (restriction on constructive notice).

33. *Motor Vehicles Securities Act 1984* (Tas) sec 14; see also *Motor Vehicles Securities Act 1986* (Qld) sec 26; *Chattel Securities*

Act 1987 (Vic) sec 9; *1987* (WA) sec 7; *Registration of Interests in Goods Act 1986* (NSW) sec 9; *Goods Securities Act 1986* (SA) sec 11; *Registration of Interests in Goods Act 1990* (ACT) sec 8; *Registration of Interests in Motor Vehicles and Other Goods Act 1989* (NT) sec 13.

interest in that motor vehicle or trailer at the time he pays the purchase price or the first part of the purchase price—

- (a) the security interest in that motor vehicle or trailer is extinguished; and
- (b) the purchaser acquires the interest purchased in that motor vehicle or trailer free from the security interest.

14(2) The onus of proving that an interest in a motor vehicle or trailer is acquired free from a security interest in that motor vehicle or trailer is on the person who asserts that the interest in the motor vehicle or trailer is so acquired.

14(3) In any proceedings before a court, a document purporting to be a certificate under the hand of the Registrar relating to an entry in the register or to the absence of such an entry shall be admissible and be evidence of the matters specified in the certificate.”

The purchaser is relieved from the need to check the register to obtain a clear title if, and only if, the dealer has such a certificate. If there is a registered security interest in the vehicle, the loss falls upon the dealer who has failed to search the register or upon the undischarged credit provider, not the purchaser. The purchaser will obtain good title in this situation.

On the other hand, all people who purchase vehicles privately are required to check the register in order to ensure that the vehicle is unencumbered. Anyone who then purchases goods subject to a registered security interest takes those goods subject to that interest.

— Case examples —

When Purchaser 1 bought its Falcon XD car in 1984 financed on hire-purchase by Custom Credit (A), A in the normal course registered its security interest with the Vehicles Securities Register. Before buying the car from a car dealer two years later, Purchaser 2, aware that the car had been re-registered with new registration plates, checked title with the Register (but only under the new registration) and was advised that there was no security interest registered, whereas in fact A's interest had not been discharged. As innocent purchaser from a licensed car trader, in good faith and without notice of any security interest, Purchaser 2 was held to have received clear title: the automatic extinguishing of A's security interest as a result of this purchase gave A the right to claim from the guarantee fund established under the *Motor Car Traders Act 1973* (Vic).

— *Custom Credit Corporation Ltd v Road Traffic Authority*
(*Vehicles Securities Register*)³⁴ —

NSW v SA. Owner A (the defendant) leased a BMW car to B in New South Wales. Without the consent of A, B purported to transfer the lease to C. C took the car to South Australia, transferred its New South Wales registration to South Australia and as apparent owner purported to sell the car to P (the plaintiff). Just before settlement, P was told over the phone by the SA Vehicles Securities Register (VSR) that there was no encumbrance on the car. The car was later repossessed by A and sold. The Commercial Tribunal

34. (1988) ASC ¶55-647.

held in favour of P: good title passed to P and the security interest of A was discharged because A's security interest was not registered in South Australia at the time of sale. Reciprocal registration of security interests did not yet exist: although A's interest was registered on the NSW Register of Encumbered Vehicles (REVs), A would have had to register separately in South Australia for protection in South Australia.

_____ *Springett v Leasco Australia Pty Ltd*³⁵ _____

¶14-370 Priorities between competing interests. One of the reasons for the enactment of the various pieces of motor vehicles securities legislation was to determine which of two innocent persons would lose the car — a secured party (mortgagee, lessor or hirer of goods) or the subsequent purchaser of an interest in the goods in good faith and without notice of the security.

Previously, any ownership competition depended upon whether the secured party's interest was legal or equitable (¶13-200—¶13-220; ¶13-040—¶13-048) and was resolved according to the rules set out at ¶13-270.

The chattel securities laws in the different jurisdictions take one of two approaches to the question of priority. Some regulate priorities only between security interests registered under those laws, and leave the priority of unregistered security interests to the common law.³⁶ The chattel securities laws in other jurisdictions do not address priority at all and leave priority to the common law (¶13-270).³⁷

The chattel securities laws provide no protection to an innocent purchaser from a thief, and the extinguishment provisions would not apply. (Some jurisdictions such as New South Wales and Western Australia have a scheme whereby, through co-operation with police, consumers are able to be advised of stolen vehicles.)

The priority rules do not apply to a security interest that is a registrable charge to which the Corporations Law applies (Chapter 2K: ¶13-540).

¶14-380 Compensation. Should it happen that a systems malfunction in the register causes it to record incorrect search details, the holder of a security interest in a motor vehicle — such as a finance company — may

35. (1992) ASC ¶56-116. This problem would not arise today as SA is now a participating State in the national scheme, the National Vehicle Security Register. Other chattel security cases include *Woods v Nissan Finance Corporation Ltd* (1987) ASC ¶55-612; (1987) 5 MVR 436; *Registrar of Security Interests v Psarros* (1989) 51 SASR 318, noted (1990) 64 LJ 635; *Australian Central Credit Union v Commonwealth Bank of Australia* (1991) 9 ACLC 396 (charge registered under

company law (¶13-540) did take priority over registration on motor vehicles securities register).

36. eg *Chattel Securities Act 1987* (Vic) sec 10; *Motor Vehicles Securities Act 1986* (Qld) sec 12; *Goods Securities Act 1986* (SA) sec 12.

37. *Registration of Interests in Goods Act 1986* (NSW), 1990 (ACT); *Registration of Interests in Motor Vehicles and Other Goods Act 1989* (NT).

find that a purchaser has acquired the vehicle free and discharged from that interest (¶14-340). In this situation, except in the case of Tasmania, access to compensation from the register or from the guarantee fund set up under car dealers legislation (as in the *Custom Credit* case: ¶14-360) is available. No compensation is payable if an application for registration is rejected for inadequate information, or if the registration is cancelled as allowed by the legislation.³⁸ An appeal procedure is afforded to those parties who have their compensation applications rejected. In this way, an innocent security holder, as well as the innocent purchaser, may be protected.

38. eg *Registration of Interests in Goods Act 1986* (NSW) sec 13(2); *Registration of*

Interests in Motor Vehicles and Other Goods Act 1989 (NT) sec 17(2).

Chapter 15

Bailment

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CONCEPT AND CLASSIFICATIONS _____

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¶15-010 Definitions of bailment. Bailment, arising whenever one person (the bailee) knowingly and willingly comes into the possession of goods belonging to another person (the bailor), is a very common everyday occurrence.¹ People pass possession of their goods to a bailee when they leave a car at a garage to be serviced, deliver goods “on approval” or “on sale or return”, leave goods with a carrier or courier to be transported or leave an item for drycleaning or repair.

The classic definition, formulated in 1736,² states:

1. Derived from the old French verb *bailler*, to deliver.

2. Bacon, Matthew, *A New Abridgement of the Law*, Strahan, London, 7th ed, 1832, Vol 1, p 505.

“A bailment, properly so called, is a delivery of personal chattels in trust, on a contract, express or implied, that the trust shall be duly executed, and the chattels redelivered in either their original or an altered form, as soon as the time or use for, or condition on which they were bailed, shall have elapsed or been performed.”

This definition is based on delivery. In fact delivery is not the only method of transferring possession of goods, so the more modern definition of bailment is that—

“... a bailment comes into being whenever one person is knowingly and willingly in possession of goods which belong to another”.³

Therefore for a bailment to arise the bailor must retain ownership of the goods, the bailee must have only temporary possession, and possession must return to the bailor or be transferred to a third person according to the bailor's direction.

¶15-020 Bailment v licence — no bailment without possession. Bailment involves the transfer of possession by the bailor to the bailee. If there is no transfer of possession, the relationship may not be a bailment but instead it may be a licence: a licence is an authority to enter so as to justify what would otherwise be trespass (¶13-740). Determining whether the relationship is that of bailor/bailee or licensee/licensor depends on the circumstances, including the intention of the parties.

— *Case examples* —

Car park not liable as bailee. P parked his car at the Seaway Car Park, and upon payment received a ticket from the attendant which contained the date, the registration number of the car and an exclusion clause. When P returned, the attendant told him that he had just given the car to P's “friend”. The car was never recovered, and P sued in negligence. The court held that the relationship was that of licensee/licensor and not bailor/bailee because there was no transfer of possession of the car from P. The car park was not legally liable as a bailee (¶15-070 — ¶15-150). Further details are set out below.

— *Ashby v Tolhurst*⁴ —

Car park liable as bailee. In contrast, a car park was held liable as a bailee and in breach of an implied promise not to redeliver the car without a ticket.

— *Sydney City Council v West*⁵ —

The following tests put forward by Professor Palmer distilled from the case law indicate when a relationship is one of bailment and not licence:⁶

3. Palmer, NE, *Bailment*, The Law Book Co Ltd, 2nd ed, 1991, p 3.

4. [1937] 2 KB 242; [1937] 2 All ER 837.

5. (1965) 114 CLR 481, ¶6-240.

6. Palmer, *op cit*, pp 386-413.

(1) Has there been transfer of the means of access to or control over the item, such as handing over the keys of a car? *Ashby v Tolhurst* involved leaving a car on private property and nothing else.

(2) Is there a system for recovery such as the presentation of a ticket? Because the arrangement in *Ashby v Tolhurst* was considered to be only parking on private property, the ticket was just a receipt and the car park was not obliged to prevent unauthorised removal of the car: "This is a case where anyone can walk on to the land and get into a car".

(3) Are significant fees and charges computed and paid at the end of the period? Although a fee had been paid in *Ashby v Tolhurst*, it related to the facility (the licence to park) rather than any undertaking of custody.

(4) Are the premises laid out for security? In *Ashby v Tolhurst*, the car park was in the shape of a triangle with two sides open. Possession of the car did not pass to the car park.

(5) Does the proximity of the owner mean that possession is not given to the other person? The cloakroom and locker room cases extracted below show that there is bailment only if control cannot be exercised by the owner.

(6) Are there attendants? Apparently if the attendants in *Ashby v Tolhurst* saw someone they knew to have no authority removing a car, they were under "no obligation whatever to move one finger to stop it".

(7) Is possession necessary for the non-owner's purpose? In *Ashby v Tolhurst* the court stated that if the car had been left for any particular purpose (such as to be sold, to be pledged, to be driven to another location or indeed to be left for safe custody), delivery of possession and therefore bailment would have been inferred.

(8) Are tickets and other documentation described in terms of bailment? In *Ashby v Tolhurst* the car owner (P) failed in an attempt to establish that the exclusions on the ticket inferred that the car park was under a contract of bailment. (Exclusions on tickets are an important topic in contract law: ¶6-180 — ¶6-240.)

(9) Does the commercial standing of the other party or previous dealings with it indicate intention to enter a bailment relationship?

(10) Is the value of the goods such that it is reasonable to assume that the other party took responsibility for the goods as bailee?

(11) Is the other party only renting out space? For example, a bank is not the bailee of items stored in a rented safe deposit box.⁷

In the words of Professor Palmer,⁸ "in the ordinary run of events, the unattended hotel or restaurant car-park will clearly not produce a bailment, while the modern multi-storey car-park, with its careful checks on incoming

7. eg *FC of T v Australia and New Zealand Banking Group Ltd (Smorgon's case)*, ¶16-080.

8. Palmer, *op cit*, p 413.

and outgoing cars and cumulative fee in return for parking space and tickets to be presented before allowing departure, will almost invariably do so.”

The following three cases illustrate all these tests:

— *Case examples* —

Hotel not liable as bailee. Before going into a public house for refreshment, the plaintiff left his motor cycle in a closed yard adjoining and forming part of the premises. The yard was unattended, and when the plaintiff left the public house he found that his cycle had been stolen. It was held that there was no delivery of possession to the licensee of the hotel, either actual or constructive, and therefore the licensee was not liable for its loss.

— *Tinsley v Dudley*⁹ —

Restaurant liable as bailee of coat. When the plaintiff entered the defendant’s restaurant to dine, his coat was taken from him by a waiter who hung it up immediately behind the plaintiff. The coat was missing when the plaintiff had finished his meal. Holding in favour of the plaintiff on the ground of negligence, the judge had first to determine “whether the facts show a bailment of the coat, or merely that it was taken by the waiter as an act of good nature or service, without any intention of taking charge of it. I think that the jury were justified in finding, on the evidence before them, that the coat was bailed to the defendant.”

— *Ultzyen v Nichols*¹⁰ —

Clothes missing from locker: Council not liable as bailee. The plaintiff hired a locker at Waverley Council’s dressing sheds at Bondi Beach. He placed his clothes and effects therein, locked it, returned the key to the attendant and went to the beach. When he returned, the locker was empty. The plaintiff sued the Council, contending that it was a bailee of his effects and that it owed him the duty of care of a bailee, but he failed on the basis that the mere deposit of clothes in a hired locker was insufficient to raise evidence of a bailment even though the attendant retained the key while the plaintiff was at the beach.

— *Greenwood v Council of the Municipality of Waverley*¹¹ —

¶15-030 Bailment: redelivery of the same goods. Bailment involves the redelivery of the identical goods bailed. Anything less than this does not amount to a bailment in law. For example, it has been held that where wheat in unmarked bags is delivered to a wheat merchant, the merchant (without words to the contrary) does not become a bailee of the wheat, because a bailment involves redelivery of the identical subject matter:¹²

“The arrangement is inconsistent with the very idea of bailment according to English law, which involves the redelivery of a specific thing in its original or some altered form to the bailor or to some other person in accordance

9. [1951] 2 KB 18; [1951] 1 All ER 252.

10. [1891-94] All ER Rep 1202.

11. (1928) 28 SR (NSW) 219.

12. *Chapman Bros v Verco Bros and Co Ltd* (1933) 49 CLR 306, per Rich J at p 314, per Starke J at p 316.

with the terms of the bailment. Our attention was called to some decisions of State Courts in the United States of America in which the identity of subject matter was held to be unessential to a bailment when the subject matter was wheat. This is a departure from the common law. ...”

“If the identical subject matter is to be restored, either as it stood or in altered form, the case is one of bailment. If, on the other hand, the identical subject matter, either as it stood or in altered form, is not to be returned, but a different thing of equal quantity and quality may be given as an equivalent, then a bailment is not created: it is a transfer of property, and the title to the thing originally delivered vests in the transferee.”

¶15-040 Classification of bailments. Bailments take many forms — gratuitous, for reward, at will, for a term, etc — and to actually determine whether a transaction is or is not a bailment in law can be important in sorting out legal liabilities. If a transaction can be construed as a bailment, and in the absence of any contract between the parties to the contrary, it will be regulated by common law bailment principles.

The main value of any classification of bailments is to indicate the wide range of relationships governed by bailment principles. In 1703 the following classification was laid down by Chief Justice *Holt* (headings added):¹³

“In order to shew the grounds, upon which a man shall be charged with goods put into his custody, I must shew the several sorts of bailments. And there are six sorts of bailments.”

- (1) *Gratuitous safekeeping*. “The first sort of bailment is, a bare naked bailment of goods, delivered by one man to another to keep for the use of the bailor; and this I call a depositum”
- (2) *Gratuitous loan*. “The second sort is, when goods or chattels that are useful, are lent to a friend gratis, to be used by him; and this is called commodatum, because the thing is to be restored in specie.”
- (3) *Hire*. “The third sort is, when goods are left with the bailee to be used by him for hire”
- (4) *Pledge*. “The fourth sort is, when goods or chattels are delivered to another as a pawn, to be a security to him for money borrowed of him by the bailor; and this is called in Latin vadium, and in English a pawn or a pledge.”
- (5) *Contract of work and labour*. “The fifth sort is when goods or chattels are delivered to be carried, or something is to be done about them for a reward to be paid by the person who delivers them to the bailee, who is to do the thing about them.”
- (6) *Gratuitous work and labour*. “The sixth sort is when there is a delivery

13. *Coggs v Bernard* (1703) 2 Ld Ray 909 at p 912; 92 ER 107 at p 109.

of goods or chattels to somebody, who is to carry them, or do something about them gratis, without any reward for such his work or carriage”

Arguably this classification is incomplete because in recognising safekeeping “without reward” (class (1)), it fails to recognise safekeeping for reward (such as a solicitor or bank holding documents for safekeeping). Of these six enumerated classes, classes (1), (2) and (6) can be categorised as gratuitous bailments while the rest are bailments for reward (contracts for bailment).

Quasi bailment. If a person such as a carrier does not pick up the goods personally but transfers possession to a sub-carrier by transferring the paperwork, the carrier cannot avoid responsibility for the work of the sub-carrier and remains liable to the owner in negligence, etc as “quasi-bailor”.¹⁴

¶15-050 Bailment created by contract. A bailment arises at law either by virtue of a relationship of possession or by virtue of contract between parties. Rights and remedies arise at common law, and may be qualified if the bailment is created by contract. In particular, rights and remedies arising at common law may be limited or excluded by an appropriately drafted exclusion clause (¶6-180 — ¶6-240; ¶15-150) subject to certain statutory limitations (¶15-150; ¶7-170 — ¶7-205).

Where bailment arises by contract, the consideration for the contract of bailment is the bailor’s parting with possession of his goods. Such a bailment is an enforceable simple contract even if no money has changed hands.

When there is a contract, the law will require the parties to abide by their contract and will not allow it to be overridden by common law principles:¹⁵ “... in my view, where the defendant has protection under a contract, it is not permissible to disregard the contract and allege a wider liability in tort” (or bailment).

— *Case example* —

P promised D that he would leave an amount owing by D outstanding for two years. Before this period expired, P sued D for recovery of the amount. By way of defence, D submitted that the handing over of the money gave rise to a legally binding quasi-bailment (called *mutuum*). In finding for P, the court held that the effectiveness of the transaction was to be determined according to the agreement between the parties, and because P’s promise was unsupported by consideration from D (see ¶5-400) the promise was not enforceable against P. Accordingly, P was not bound by the agreement and could demand return of the money.

14. eg *Metaalhandel JA Magnus BV v Ardfields Transport Ltd* [1988] 2 Lloyd’s Rep 197, discussed by Palmer, N, *Quasi-bailment and possessory title* (1995) 3 Tort L Rev 186.

15 *Hall v Brooklands Auto Racing Club* [1933] 1 KB 205 at p 213.

Because the agreement was defective under contract law the result was that, in so far as it was defective in contract, it could not be operative under bailment law: the agreement between the parties overrode the general principles of bailment law.

— *Parastatidis v Kotaridis*¹⁶ —

Accordingly, as stated by Palmer:¹⁷

“It emerges from the foregoing analysis that duties arise under a bailment in two principal ways: by implication of law, as a result of the possessory relationship, or by virtue of an agreement between the parties. When the agreement is simultaneously a contract, there will be a contractual right of action to enforce any obligations which the parties have superadded to those owed at common law. Thus, if a bailee by contract undertakes to assume a strict liability for the goods, or to store them by a particular method, an action will lie in contract for breach of that promise. But if such a promise is enforceable against even a non-contractual bailee (eg a mandatory or unpaid custodian) it would seem to follow that promissory obligations undertaken pursuant to any form of bailment are not exclusively contractual in character. Contract, under an executed bailment, becomes an accessorial remedy, because the promise could have been enforced without it. The central or primary remedy becomes an action for breach of bailment.”

¶15-060 Examples of bailment arising without contract.

Not all bailments are created by contract, and general principles of the law of bailment remain important particularly because there are a number of instances where a bailment relationship can be created in the absence of a contract between the parties. An action in bailment is separate and distinct from an action in tort or contract.¹⁸

Sub-bailment by bailee. If a person (A) delivers goods to a bailee (B) for transporting, processing, etc, and if the bailee consigns the goods to a third person (C, the sub-bailee), the relationship of bailor and bailee arises between A and C even though there is no privity (¶6-260 — ¶6-270) and no contract between them. Bailor A is bound by the terms of B’s sub-bailment only if A has expressly or impliedly consented to B’s sub-bailing to C.¹⁹

— Case examples —

The plaintiff sent a fur stole to a furrier for cleaning. With the plaintiff’s consent, the furrier sent it on to the defendants, who were expert fur cleaners. While the fur was in the possession of the defendants, it was stolen by one of their employees (on the vicarious liability of the bailee, see ¶15-140). The

16. [1978] VR 449.

17. Palmer, NE, *Bailment*, *op cit*, pp 64-65 (citations omitted).

18. *American Express Co v British Airways Board* [1983] 1 All ER 557 at pp 559-560.

19. *The Pioneer Container; KH Enterprise v Pioneer Container* [1994] 2 All ER 250.

case was decided on the basis that “the voluntary taking by a sub-bailee of the owner’s goods into his custody of itself results in his owing to the owner the duties of a bailee” because the relationship of bailor and bailee came into existence by sub-bailment. Therefore the bailee was in breach of the common law duties of bailee to bailor (¶15-070 — ¶15-150).

_____ *Morris v CW Martin & Sons Ltd*²⁰ —

Bailor (P) contracted with Bailee to send goods from Melbourne to Burnie under a contract which excluded the liability of Bailee and its servants, agents and subcontractors including liability for negligence. Bailee subcontracted with Sub-bailee (D), under a contract which did not expressly exclude liability for negligence, to carry the goods from Devonport to Burnie. The goods were stolen at Burnie due to negligent storage by Sub-bailee. Bailor succeeded against Sub-bailee, and the court held that Sub-bailee was not protected by the exclusion clause in the Bailor/Bailee contract because of the absence of privity of contract (¶6-265).

_____ *Philip Morris (Aust) Ltd v The Transport Commission*²¹ —

Gratuitous bailee. A person can be a bailee by taking possession of another person’s goods even if receiving no payment. Gratuitous bailments, regulated by common law bailment principles, include deposit of goods for safe keeping (for no payment), deposit of goods for repair free of charge and loan of item — say, a car — to a friend for no charge.²²

Bailment by finding. A person finding goods is not a true bailee because the goods have not been bailed to that person for some particular purpose. But if a finder takes possession of the goods, and is somehow negligent and causes loss or damage to the goods, the finder may be liable for the damage caused.

— *Case example* —

After having tried on a coat at the defendants’ shop, the plaintiff accidentally left a diamond brooch on a show case in the shop. The brooch was found by a shop assistant who handed it to a senior employee who, in breach of the shop rules, put it in his desk. When the plaintiff returned to collect it, the brooch could not be found. It was held that the defendants had become bailees, had not taken reasonable care of the brooch and were liable to compensate the plaintiff.

_____ *Newman v Bourne and Hollingsworth*²³ —

Involuntary recipients. A person cannot be forced to become a bailee without agreeing to do so. If a person receives goods involuntarily, the person’s duty in law is probably no higher than to refrain from causing intentional damage.

20. [1966] 1 QB 716; [1965] 2 All ER 725; applied in eg *The Pioneer Container*; *KH Enterprise v Pioneer Container* [1994] 2 All ER 250, quoted at p 261.

21. [1975] Tas SR 128; *American Express Co v British Airways Board* [1983] 1 All ER 557 (registered mail containing travellers

cheques stolen by employee of an air carrier which was an agent of post office: post office not liable as bailee because of its statutory immunity).

22. *Coggs v Bernard* (see ¶15-040), classes (1), (2) and (6).

23. (1915) 31 TLR 209.

For example, a fraudulent rogue ordered goods in the name of the defendant, and then telephoned the defendant and claimed to be the plaintiff. The rogue stated that the goods had been delivered in error, and that he would call and collect them. He did this and absconded. The defendant (the involuntary bailee) was sued by the plaintiff in the tort of conversion (§4-020); it was held that although the defendant was an involuntary bailee, he had acted reasonably in handing over the goods, had not been negligent and was not liable in conversion.²⁴

The position of the involuntary bailee, the obligation to take reasonable care of the goods, and the legal position of a person making demands for payment for unsolicited goods, is now covered by consumer legislation (see §17-490).

DUTIES OF THE BAILEE

Duties imposed by law on the bailee	¶15-070
Bailee's duty to take care of the goods	¶15-080
Bailee's duty to retain possession	¶15-110
Bailee's duty not to use or misuse the goods	¶15-120
Bailee's duty to return the goods	¶15-130
Common carriers and common innkeepers	¶15-135
Vicarious liability of the bailee	¶15-140
Exclusion of bailee's liability for negligence	¶15-150

¶15-070 Duties imposed by law on the bailee. The obligations imposed by law upon a bailee — independently of a contract with the bailor — include the following:

- (1) the duty to take care of the goods (¶15-080);
- (2) the duty to retain possession (¶15-110);
- (3) the duty not to use or misuse the goods (¶15-120);
- (4) the duty to return the goods (¶15-130).

¶15-080 Bailee's duty to take care of the goods. The bailee's duty to take care of the goods can be summarised as follows:²⁵

- (1) All bailees — whether gratuitous (ie classes (1), (2) and (6) in *Coggs v Bernard* in 1703: ¶15-040) or for reward (the remaining classes in *Coggs v Bernard*) — owe a duty of care to the bailor under the law of negligence (¶4-060). The duty of the bailee is to take reasonable care according to the circumstances of the situation. The onus of proof is

24. *Elvin and Powell Ltd v Plummer Roddis Ltd* (1933) 50 TLR 158.

25. Based on the nine legal principles set out by Kirby P in *Tottenham Investments*

Pty Ltd v Carburettor Services Pty Ltd (1994) Aust Torts Reports ¶81-292 at pp 61,553-61,555.

on the bailor to prove negligence on the part of the bailee. Australian authority takes the view that a bailee is liable for loss or damage resulting from dealing with the goods bailed in a manner not authorised by the bailor.²⁶

Three tests will assist in determining whether or not a bailee has been negligent under the modern formulation of the standard of care.

- (i) *The type of bailment.* Is the bailment gratuitous or paid? (See ¶15-040.) What is the nature of the relationship between parties?
 - (ii) *Expertise of bailee.* Is the bailee a professional, carrying out the bailment in the course of business? What expertise does the bailee hold out?
 - (iii) *Nature of goods bailed.* A high standard of care is to be expected if the goods bailed are of special value.
- (2) If the goods are lost during the bailment, the onus is on the bailee to prove that the loss is not the result of any negligence on its part. This follows from the bailee's duty to return the goods (¶15-130).
 - (3) The duty of a bailee is not that of an insurer and therefore the bailee is not required to take every possible precaution to prevent loss of the goods. The duty of the bailee is to take the same reasonable care that any person would take over their own goods.
 - (4) If goods are destroyed or stolen during bailment, the bailee must show that it took steps which were reasonable in the circumstance to keep out intruders (eg the bailee was liable in the *Pitt Son & Badgery case*, below).
 - (5) In such a case, reasonable care will usually involve the taking of positive steps to deter would-be thieves, to prevent them from gaining access to the building in which bailed goods are kept and to prevent their easy escape.
 - (6) Failure to anticipate the loss is not necessarily evidence of negligence — "wisdom after an event does not prove negligence before".
 - (7) Foreseeability of loss or damage requires the bailee to take precautions not only for events which are "likely to happen" but also for events which are "not unlikely to occur".
 - (8) If the bailee can show *prima facie* that the theft of the bailed goods occurred without negligence on its part, the bailor may then show what could and should have been done by the bailee to prevent the loss of the goods.
 - (9) Even an exclusion clause in the contract of bailment (¶15-150) will not be effective to displace the duty of the bailee to restore the property (¶15-130) unless clear notice of the exclusion is given to the bailor.

26. *Jackson v Cochrane* [1989] 2 Qd R 23 at p 26.

With the liability of the bailee established in line with modern formulations of negligence, the following case examples illustrate the scope of the standard of care expected of a bailee, and how it varies depending on the type of bailment:

— *Case examples* —

Wool store's inadequate security. Bales of greasy wool purchased from the defendant wool broker were stored in a wool store at Hannell Street, Newcastle. The store, of timber construction, about 40 years old, with no automatic fire sprinkler, was destroyed by fire lit by a night-time intruder. The wool broker accepted that it was a bailee with duties analogous to those of a bailee for reward. The High Court held the broker liable in negligence for failure to take reasonable care to keep the wool secure by providing an adequate fence: "The tortious act of the intruder was of the very kind which the [broker] was obliged to take reasonable care to prevent".

— *Pitt Son & Badgery Ltd v Proulefcso SA*²⁷ —

The landlady and the lodger. When the lodger departed, he left some personal effects including nine stamp albums valued at \$30,000 with his former landlady. When she failed to redeliver them, she was held in breach of her duty as a gratuitous bailee to take reasonable care of the goods bailed and to deliver them up when an unequivocal demand was made (¶15-130).

— *Graham v Voigt*²⁸ —

Free parking by car jockey. When P went to D's nightclub, P handed his BMW and its key to a car jockey to drive to a nearby public car park and received a ticket in return. There was a red notice containing an exclusion clause at the entrance. When P left the nightclub, neither the car nor the key could be found. Although the car jockey was not employed by D, but by an independent contractor, the court treated the jockey as a servant or agent of D. When the car was delivered to the car jockey, the relationship of bailor and bailee arose — it was irrelevant where the car was to be parked. The bailment was a bailment for reward (as D derived benefit from providing for parking). The Singapore High Court held that as there was no explanation why the car was lost, P succeeded in negligence and in breach of duty as bailee (whether bailee for reward or gratuitous bailee).

— *Chua Chye Leong Alan v Grand Palace Deluxe Nite Club Pte Ltd*²⁹ —

27. (1984) 153 CLR 644; (1984) 58 ALJR 246; (1984) 52 ALR 389.

28. (1989) 95 FLR 146; (1989) 89 ACTR 11; (1989) Aust Torts Reports ¶80-296.

29. [1993] 3 Singapore Law Reports 449, noted (1994) 68 ALJ 836. Because there

was evidence of negligence even though the precise cause could not be shown, P could rely on *res ipsa loquitur* to prove negligence as "the thing speaks for itself".

Carburettor repairs. Thieves entered through a skylight at D's garage at night and stole P's imported RS Camaro coupé, a "collector's item". P was successful in claiming compensation from D — the keys had been left in the ignition of the car, the premises were not protected with security bars and an alarm system, and there were no warning signs of alarms. The legal principles stated in this case by Kirby P are set out above.

*Tottenham Investments Pty Ltd v Carburettor Services Pty Ltd*³⁰ —

A computer forwarded by computer company P to client D was not suitable, and D returned the computer via a carrier (not a common carrier: ¶15-135). When the computer was returned, it was found to be damaged. The Supreme Court held that D did not have an absolute duty to "hold safe" the computer for P: D as bailee was not an insurer, owed no absolute duty and was not liable for the acts of third parties unless D was negligent. In the words of *Coggs v Bernard* (¶15-040), "[h]e is only to do the best he can".

*Speedycom Pty Ltd v Graphic Computer Systems Pty Ltd*³¹ —

A warehousekeeper was held liable to a publisher for the loss of reels of newsprint when the warehouse burned down. The warehouse was overloaded in breach of local government bylaws and it did not have fire sprinklers, but the cause of the fire was unknown. The court confirmed that "At common law, a custodian for reward must exercise reasonable care for the safety of the property entrusted to it. The degree of care is that which may reasonably be expected from a skilled warehousekeeper acquainted with the risks. As to the burden of proof, in an action for negligence the general rule is that the plaintiff must prove a breach of the duty of care. But when the goods or property are damaged in the possession of a bailee, the bailee must prove either that it took appropriate care of them, or that its failure to do so did not contribute to the loss. The bailee's burden of proof is not merely a shifting onus, or the onus of going forward with evidence. It is what is sometimes described as an 'ultimate onus'. Whilst the bailee does not face the burden of providing an exact explanation of the event or injury, if a defendant leaves it doubtful whether the particular damage was due to its fault, the plaintiff should succeed."

*Wilson & Horton Ltd v Attorney-General*³² —

P contracted with D to move goods interstate. D had the goods moved by rail, and upon arrival they were stored at the rail terminal in D's storage shed which D leased from the rail authority. The goods were stolen from D's shed during the night, which was locked but unstaffed. There was no security at the rail terminal. As D's liability under the P/D contract was limited to \$500, P sued the rail authority in negligence. P was unsuccessful: the rail authority was not a bailee or sub-bailee as it did not assume possession of or control over the goods during the period of storage. The rail authority,

30. (1994) Aust Torts Reports ¶81-292 (NSW Court of Appeal).

31. Magistrates Cases 1997, Part 3, 12/97, p 36 (Victoria).

32. [1997] 2 NZLR 513 at p 526 (Ct of Appeal).

as lessor, was under no duty to control or to detect the activities of thieves on its leased premises.

*WD & HO Wills (Australia) Ltd v State Rail Authority of New South Wales*³³ —

D (a landlord) who evicted P (a tenant) for non-payment of rent was held liable as a bailee for reward for the loss, due to D's negligence, of valuable goods of P worth \$40,000. However, P was liable for contributory negligence calculated at 75% of the loss, and with a set-off for outstanding rent D was held liable for \$4,530.

*Bowden v Lo*³⁴ —

¶15-110 Bailee's duty to retain possession. Although the general principle of bailment law is that the bailee is under an obligation to retain possession of the goods bailed, it can sometimes be implied that a bailee is entitled to make a sub-bailment (¶15-060). If it can be inferred that goods were delivered to a bailee for the bailee's individual skill or qualifications, the law provides that this bailee cannot delegate without the consent of the bailor. Depending on the circumstances, the repairer of a car can quite reasonably send away a part to another firm for repairs; a carrier of goods may transfer the goods to another carrier for part of the journey, and a hirer of goods may quite lawfully sub-hire the goods.

¶15-120 Bailee's duty not to use or misuse the goods. The nature of the bailment (and the terms of the contract if there is one)³⁵ define the extent to which the bailee can use the goods bailed. Unauthorised use of the goods by the bailee may—

- entitle the bailor to sue in the torts of conversion or trespass (¶4-020);³⁶

“Any act or disposition which is wholly repugnant to or as it were an absolute disclaimer of the holding as bailee revests the bailor's right to possession, and therefore also his immediate right to maintain trover or detain even where the bailment is for a term or is otherwise not revocable at will, and so *a fortiori* in a bailment determinable at will.”;

- convert a bailment for a fixed term into a bailment revocable at will;
- if the use is contrary to the terms of a contract between the parties, allow the bailor to sue for breach of contract.

¶15-130 Bailee's duty to return the goods. The bailee's duty to restore the goods to the bailor is qualified by the nature of the bailment.

33. (1998) 43 NSWLR 338; (1998) Aust Torts Reports ¶81-473; noted (1998) 72 ALJ 512.

34. (1998) NSW ConvR ¶55-868, noted (1998) 72 ALJ 598.

35. The terms of a contract override the general principles of bailment law (¶15-050).

36. Pollock, F and Wright, RS, *An Essay on Possession in the Common Law*, Oxford, 1888, pp 132-133.

If the bailment is a bailment at will, the goods must be returned on demand. In contrast, if the bailment is for a fixed term, the goods must be returned without demand either at the end of the specified period or where the bailee is in breach of the bailment.

Failure to return the goods as provided can expose a bailee to possible legal action in—

- the tort of detinue (wrongful detention) (§4-020). However, it may be a defence for the bailee to show that the goods were lost, stolen, destroyed or damaged without fault on his part;
- the tort of conversion (dealing with goods in a manner inconsistent with the rights of the owner) (§4-020);
- the tort of negligence (§4-060ff).

¶15-135 Common carriers and common innkeepers. An absolute duty is imposed upon bailees described as “common carriers” and “common innkeepers”. The duty imposed is higher than a mere duty to take care, and is an absolute duty to make good any damage to or loss of the goods of the bailor. Because this law virtually treats these bailees as insurers, their liability has been restricted in some jurisdictions by various statutes governing railways, carriage of goods, civil aviation and innkeepers/hotelkeepers.

A *common carrier* is a carrier who undertakes to transport goods — by land, water or air — for all comers without discrimination. (In contrast, private carriers do not hold themselves out as available to all, reserve the right to refuse business and are not necessarily liable for goods lost or damaged if they can disprove negligence on their part.) A common carrier can refuse to carry the goods, for example if there is no capacity, if reasonable charges are not paid in advance, or if the goods are not properly packed.

The liability of a common carrier is based on liability as a bailee of goods.³⁷ As legislation deems government railways to be common carriers, they face liability as common carriers of goods. Railways are not common carriers of persons, as there can be no bailment of a person.³⁸

A common carrier is under strict liability for lost or damaged goods. Fault or negligence do not have to be proved. Defences available to the common carrier include proof that the loss or damage was caused by one of the four common law excepted perils: (1) Act of God; (2) act of the Queen’s enemies or seizure by public authorities; (3) inherent fault in the goods carried, or (4) the fault or fraud of the consignor or consignee.

37. Under the fifth classification in *Coggs v Bernard*, ¶15-040.

38. eg *Government Railways Act 1904* (WA) sec 37, discussed in *Connors v The*

Western Australian Government Railways Commission (1992) Aust Torts Reports ¶81-187, ¶4-160.

A *common innkeeper* is a person who carries on the business of offering lodging to travellers as transient guests — provided that they are prepared to pay a reasonable price, that no reasonable objection can be taken to their condition and that there is room available. “Inns” include motels and licensed hotels, but may exclude private or residential hotels. A “guest” is a traveller accommodated in the course of a journey, not a boarder or lodger.

As with common carriers, common innkeepers are absolutely liable for loss or damage to the goods entrusted to them even in the absence of negligence (unless protected by special contract). If goods of the traveller are lost or stolen, the innkeeper is liable at common law unless the innkeeper can prove: (1) Act of God; (2) act of the Queen’s enemies or seizure by public authorities, or (3) negligence of the guest. Legislation in most jurisdictions confirms the common law, but provides upper limits on the liability of the innkeeper/bailee. Notice of this may be required both at the reception desk and in the room of the traveller (cf ¶6-220).

¶15-140 Vicarious liability of the bailee. “Vicarious liability” is the expression used when the law holds one person responsible for the misconduct of another even though the first person is not at fault (see, eg, ¶4-270).

As the law requires the exercise of all reasonable care, a bailee for reward is liable for its own negligence and for the negligence of its agent or employee (in legal language, its “servant”).³⁹ In the restaurant case discussed at ¶15-020, the restaurant owner was held accountable to the customer as bailee when the customer’s coat was stolen after having been taken and hung up by the waiter.

¶15-150 Exclusion of bailee’s liability for negligence. Quite naturally, and as a result of the responsibilities of the bailee, the bailee may — or may attempt to — modify or exempt himself (or his “servants”) from potential liability in negligence. Liability at common law cannot be excluded, but if there is a contract between the parties, the issue arises whether an exclusion clause in the contract, or a notice in a shop, on a ticket, etc will be legally effective to limit the bailee’s liability.

The principles governing exclusion clauses (many of which were established in bailment cases) are discussed at ¶6-180 — ¶6-240. The right of a sub-bailee (such as a stevedore, carrier, shipping agent, etc) to protection by an exclusion clause contained in the bailor/bailee contract to which it is not party raises privity of contract issues and is discussed at ¶6-265.

However, these contract law principles must now be read in the light of statutory initiatives such as those of the *Trade Practices Act 1974* (Cth). In particular, sec 74 (and *Fair Trading Act* equivalents in all States/Territories)

39. *Makower, McBeath and Co Pty Ltd v Dalgety and Co Ltd* [1921] VLR 365.

implies non-excludable (§7-170) implied warranties that services will be rendered with due care and skill (sec 74(1)), and that where their purpose is known, they will be reasonably fit for that purpose (sec 74(2)) (§7-095). “Services” are defined widely in sec 4 (§7-290) but for the purposes of sec 74, they exclude business or non-consumer transportation or storage of goods (sec 74(3)).

DUTIES OF THE BAILOR _____

Duties imposed by law on the bailor §15-160
 Bailor’s duty not to interfere with
 bailee’s possession §15-170
 Bailor’s duties regarding quality and fitness §15-180

§15-160 Duties imposed by law on the bailor. The common law imposes the following two obligations on the bailor (independently of any contract, see §15-050):

- (1) Bailor’s duty not to interfere with bailee’s possession (§15-170).
- (2) Bailor’s duties regarding quality and fitness of the goods (§15-180).

§15-170 Bailor’s duty not to interfere with bailee’s possession. The essence of bailment (compared to a licence, for example) is the transfer of possession to the bailee. It is accepted, however, that if the bailment is at will, the bailor may retake the goods subject to the limits of the right of recaption.⁴⁰

If the bailment is for a fixed term, the bailor cannot interfere with the bailment and retake possession. To do so could render the bailor liable in trespass, conversion and possibly for breach of contract.

§15-180 Bailor’s duties regarding quality and fitness. Bailments regulated by statute, such as hire-purchase/consumer credit contracts, have conditions of fitness and merchantability implied into the contract by virtue of the statute.

Bailments not regulated by statute impose certain obligations on to the bailor as regards dangers and safety. A bailor must make known to the bailee dangers of which the bailor is aware; a bailor who fails in this duty may be liable to a person injured.

If the bailor has observed a standard of care which is reasonable in all the circumstances, the bailor will not be in breach of duty to the bailee.

40. Recaption is the right to lawfully claim or retake goods, etc, but not in a way that causes a breach of the peace.

— *Case examples* —

A market gardener (the bailor) gratuitously lent (bailed) an onion-sorting machine to a fellow market gardener (the borrower — the bailee). When the machine was new, it had a guard but the bailor had taken it off. The bailor gave the bailee instructions on how to use the machine, and warned him that children should not be allowed near it when it was going. The bailee did not follow this advice, and used the machine with the help of P (a 13-year-old boy). P's hand was crushed in the machine, and P sued the bailor and the bailee for compensation:

- (1) The bailor was not liable. The bailor was under a duty to warn of dangers that might arise from operating the machine, and he had sufficiently discharged that duty by the directions he had given the bailee on how to use the machine.
- (2) The bailee was liable to his injured offside in negligence.

Pivovarov v Chernabaeff ⁴¹

P's shopping trolley was loaded with groceries and her six-month-child. When its front wheel collapsed in the supermarket car park, P was injured when she tried to stop the trolley toppling over. P (the bailee) was unsuccessful in suing D (the bailor supermarket) for negligence for its failure to maintain the trolley in working order. There was no evidence that a system of checking beyond that already carried out by D would have revealed the defect with "certainty".

Cottee v Franklins Self-Serve Pty Ltd ⁴²

REMEDIES AGAINST THIRD PARTIES

¶15-190 Remedies of bailor and bailee against third parties.

If goods which are bailed are damaged, interfered with, etc by a third party, the circumstances will determine who is entitled to sue that third party.

Bailment at will. Where the bailor is entitled to immediate possession of the goods bailed, the bailor is the person entitled to sue a third party for trespass, conversion, detainee or negligence in regard to the goods. However, the bailee also has the right to bring an action for trespass or damages in accordance with the general principle of law that possession gives title as against a stranger.

Bailment for a term. Where the bailee's legal possession of the goods is fixed, the bailee has essentially all the rights of an owner as regards third parties interfering with his possession. Hence, a bailee can sue a third party in trespass, as can a servant or agent holding under a revocable bailment on behalf of the person having the right to possession. However, if the interference with the goods adversely affects the bailor's reversionary interest or absolute property in the goods (eg by damaging or destroying them so that the bailor would not be able to receive them back in good order at the end of the term of the bailment) then the bailor can bring an action against the third party.⁴³

41. (1978) 21 SASR 1.

Australia Ltd v BS Stillwell Ford Pty Ltd
(1979) 21 SASR 142.

42. [1997] 1 Qd R 469.

43. *Penfolds Wines Pty Ltd v Elliott* (1946)
74 CLR 204 at pp 226-227; *Citicorp*

For example, A lends his car to B, stipulating that he may call for its return at any time. C steals or damages the car while B is in possession. A (as well as B) can sue C in trespass.⁴⁴ This example applies equally to a bailment at will and a bailment for a term.

The party suing the third party must account to the other for the value of the other's interest.

TERMINATION _____

¶15-200 **Termination of bailment.** Termination of the bailment relationship may occur in the following circumstances:

- Agreement — such as the expiry of the period agreed or the fulfilment of the purpose for which the bailment was created.
- Unilateral request — especially in the instance of a bailment at will, by the bailor (for example) calling in the loan, or, where appropriate, by the bailee for reward exercising the statutory power of sale over uncollected goods. This is a power providing statutory protection to a bailee from liability for conversion when left with goods against the bailee's wishes — under the disposal of uncollected goods legislation in each jurisdiction, the purchaser acquires good title free of any charge or any other mortgage in favour of the bailee of which the purchaser was unaware (¶13-280). At common law, and depending on the goods, the bailment can be terminated upon the bailee giving reasonable notice to the bailor of intention to terminate the bailment.
- Passage of time. The bailee's duty to take care of the goods does not extend for an indefinite or perpetual period and, if not renewed or renegotiated, terminates after a reasonable time has elapsed: in the case of "[f]orty tons of rusted steel dumped at a shipyard by a vessel in a hurry", six months was held to be a reasonable period for safekeeping.⁴⁵ During the bailment, the bailee is probably entitled to a contractual right for storage charges, and may be entitled to an increase in charges after a sufficient period.
- Destruction of the goods.
- Wrongful act of the bailee — such as the bailee selling the bailed goods. This revives the bailor's right to immediate possession and gives the bailor the option to terminate the bailment.

44. Palmer, NE, *op cit*, p 205.

45. *Maritime Coastal Containers Ltd v Shelburne Marine Ltd* (1982) 52 Nova Scotia Reports (2d) 51; (1982) 106 Atlantic Provinces Reports 51 at p 69. A longer period may be required for a smaller,

more expensive and more easily stored item, as in *Moorhouse v Angus & Robertson (No 1) Pty Ltd* [1981] 1 NSWLR 700 (author's manuscript), both discussed in Palmer, NE, *Bailments and licences: possession and the duty of care* (1986) 60 LIJ 64.

Chapter 16

Cheques and Banking

Following the 1998 amendments to the *Cheques Act 1986* (Cth), every reference in this chapter to “bank” has been replaced with “financial institution”.

THE AUSTRALIAN FINANCIAL SYSTEM	¶16-010—¶16-020
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CHEQUES	¶16-190—¶16-240
CHEQUES PROCEDURE	¶16-250—¶16-330
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THE AUSTRALIAN FINANCIAL SYSTEM _____

Deregulation of the Australian financial system	¶16-010
Recommendations for changes in the financial system	¶16-020

¶16-010 Deregulation of the Australian financial system.
 The Australian financial system, once protected by government and by
 ¶16-010

distance from the rest of the world, continues to change and to adapt to new technology, the forces of competition unleashed by deregulation in the 1980s and international forces. Fundamental changes since the late 1970s include the 1991 Corporations Law administered by the Australian Securities and Investments Commission (ASIC: ¶9-380), the Commonwealth government's decision in 1983 to allow the foreign exchange rate to be determined by market forces and to suspend the exchange controls which had been substantially unaltered since the 1940s, the decision of the government in 1985 to invite 16 new overseas banks to establish operations in Australia, and the freeing of the stock exchanges and their membership by the then Trade Practices Commission (now the Australian Competition and Consumer Commission) from 1982 (¶8-660).

The role of financial institutions such as banks, building societies, credit unions, life insurance companies and merchant banks has blurred and these financial institutions are continuing to expand into areas previously the preserve of others. Following deregulation there are new financial products such as currency futures options, currency swaps, interest rate swaps, exotic swaps and Asian options. Large increases have occurred in volumes of currency and commodity futures contracts and foreign exchange transactions such as hedging and multi-currency loans. Banks now own sharebroking companies and provide a range of insurance services, and all the financial institutions are in fierce competition with investment advisers and brokers for the investment dollar.

Securitisation of loans has seen financial institutions assigning large portions of their lending portfolios to investment trusts and has prompted the development of "loan originators" as a new force in the lending market.

¶16-020 Recommendations for changes in the financial system. The Australian financial system has frequently been the subject of government inquiry to keep regulation up to date.

Appointed by the federal government in 1962, the Manning Committee recommended separate legislation dealing with cheques which later became the *Cheques and Payment Orders Act 1986* (Cth) and now the *Cheques Act 1986* (Cth) (¶16-190).

Financial deregulation. The Campbell Committee (1981), critical of government controls such as those governing foreign exchange and the entry of foreign banks, recommended a financial system marked by efficiency, competitiveness and stability. The Campbell Committee Report laid the foundation for deregulation of Australia's financial sector.¹ Further deregulation followed the report of the Martin Committee (1984), which recommended maintaining the continued distinction between banks and

1. *Australian Financial System — Final Report of the Committee of Inquiry* (Campbell Committee), AGPS, 1981.

non-bank financial institutions (such as retaining the banks' existing cheque payments system) and the ongoing prudential supervision of banks.²

The Martin Committee (1991). The Martin Committee, set up in 1990 to report on the effectiveness of deregulation and to assess its benefits to different sections of the community, supported in its report the deregulation set in motion by the Campbell Committee a decade earlier, subject to some improvements in the current approach to supervision.³

Prices Surveillance Authority (1995). The Prices Surveillance Authority, now incorporated into the Australian Competition and Consumer Commission, recommended restructure of bank fees on retail transaction accounts to promote a more efficient and equitable retail banking sector including moving the emphasis from the current fixed account-keeping fee to a variable transaction fee and removing discriminatory pricing against low-balance accounts.⁴

The Wallis Committee (1997). The "Daughter of Campbell" Committee was set up to stocktake the results of financial deregulation of the Australian financial system since the early 1980s, to establish a common regulatory framework for overlapping financial products and to propose ways of dealing with further financial innovation. Of special relevance to banking law, the Committee recommended the formation of a Payments Scheme Board under the control of the Reserve Bank to regulate the payments system; liberalisation of access to the clearing system (¶16-330); regulation of stored value cards; and laws to allow for electronic commerce (¶16-650).⁵ Some of the Wallis Committee recommendations have been given effect to in the 1998 amendments to the then *Cheques and Payment Orders Act 1986* (Cth), now renamed the *Cheques Act 1986* (¶16-190).

FINANCIAL INSTITUTION/CUSTOMER
RELATIONSHIP

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Financial institution's duty to customer	¶16-060

2. *Australian Financial System — Report of the Review Group* (Martin Committee), AGPS, 1984.

3. House of Representatives Standing Committee on Finance and Public Administration (Martin Committee), *A Pocket Full of Change — Banking and Deregulation*, AGPS, 1991.

4. Prices Surveillance Authority, *Inquiry into fees and charges imposed on retail accounts by banks and other financial institutions and by retailers on EFTPOS transactions*, Report No 65, 1995.

5. *Financial System Inquiry Final Report*, AGPS, 1997 (the Wallis Report), recommendations 61, 69, 72 and 91.

Financial institution's duty of care	
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Financial institution's duty of secrecy	¶16-080
Financial institution's duty of care in	
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Drawee institution and collecting institution	
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(2) stale cheques	¶16-120
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Position of drawee institution or collecting	
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mistake or on a forgery	¶16-160
Customer's duty to draw cheques carefully	¶16-170
Customer's duty to disclose forgeries	¶16-180

¶16-040 The legal relationship. The word “customer” is used in some sections of the *Cheques Act*, such as sec 90 (¶16-130) and sec 95 (¶16-540), yet the status of becoming a “customer”, and terminating the financial institution/customer relationship,⁶ is left to the common law (which is expressly preserved for cheques drawn on financial institutions by sec 4(2) and 4(3) of the *Cheques Act 1986* (Cth)).

Only by entering a contractual relationship with a financial institution does one become a customer of that institution. Case law has led to two propositions on this point:

- (1) there must exist a regular course of dealing, and
- (2) this course of dealing must involve transactions in the nature of regular banking business.

Merely accepting a casual service of a financial institution, such as information from its travel department or cashing a cheque of a person who is not a customer of the institution, has been held to be insufficient to make that person a customer. What is needed is the contractual relationship.

The main feature of the relationship is the conduct of an account, whether a savings account or a current account and whether newly opened or not⁷ (so long as it is not opened by a forgery). This relationship is that of debtor and creditor: unless an account is in overdraft, the financial institution

6. Jamieson, P, *Conditions under which the banker/customer relationship is terminated* (1991) 65 ALJ 85.

7. *Commissioners of Taxation v English, Scottish and Australian Bank* [1920] AC 683 at p 687.

is indebted to the customer for the amount standing in the customer's account, less any financial institution charges owing.⁸ In addition to account holders, "customer" includes those who deal with banks for borrowing, financial advice, funds management and securities dealing.

Usually the contract between financial institution and customer is based on the standard forms signed by the customer when the account is opened, supplemented by *implied* terms drawn from "the ordinary course of business" and financial institution custom (¶16-120) and by *express* terms drawn from the EFT Code of Conduct (¶16-670) and from the Code of Banking Practice (which must be in writing under cl 2.1: ¶16-041 and is administered by ASIC). Under this contract, the financial institution is to receive moneys from or on behalf of its customer for credit to an account, and is under a duty to pay either to the customer or as directed and debit the customer's balance accordingly.

As well as arising under an express term of the contract, legal liability of financial institutions arises under the implied terms of the contract (¶16-100), as a collateral contract (¶16-030) and by financial institution practice. It also arises in tort (¶14-230ff) and under the *Trade Practices Act 1974* (Cth) (sec 51A, 52, 74: ¶17-250ff).

High-handed conduct by a financial institution, such as failure to properly advise a client of the effects of a mortgage or a guarantee (¶13-360), or failure to prepare a mortgage in the terms agreed with the client, could expose the financial institution to the risk of having the transaction re-opened and rewritten by the courts for:

- unconscionability under the *Trade Practices Act* sec 51AA, 51AB, 51AC or the *Australian Securities and Investments Commission Act 1989* (Cth) sec 12CA, 12CB,⁹ (¶15-755—¶15-756), or under the *Contracts Review Act 1980* (NSW) ¶15-760), or
- unconscionability at common law (¶15-730), or
- misleading or deceptive conduct under *Trade Practices Act* sec 52 (and sec 87) (¶17-250ff). Such conduct in relation to a "financial product"¹⁰

8. *Joachimson v Swiss Bank Corporation* [1921] 3 KB 110; *Re Sildis Pty Ltd* (1988) 6 ACLC 400 at p 401.

9. These sections, which parallel sec 51AA and 51AB, were added to the *Australian Securities and Investments Commission Act 1989* (Cth) by the *Financial Sector Reform (Consequential Amendments) Act 1998* (Cth), in force 1 July 1998, to apply

to a "financial product". This definition does not apply to foreign exchange contracts or to guarantees (¶13-360).

10. A "financial product" is defined in ASIC Act sec 12BA to mean banking, securities contracts, futures contracts, insurance, retirement savings accounts and superannuation.

is regulated by the equivalent provisions of the *Australian Securities and Investments Commission Act 1989* (Cth).¹¹

Unjust transactions in the area of consumer credit can also be re-opened under sec 70 of the Consumer Credit Code (¶14-240).

Under the *Cheques Act* financial institutions may include exclusion clauses to contract out of common law liability (negligence, contract) but not statutory liability (especially under the *Trade Practices Act 1974* (Cth)) (sec 51AA, 51AB, 51A, 52, 53(g), 74: ¶7-250ff). However, there are at least three obstacles to attempts to contract out:

- (1) financial sector competition for customers (¶16-010),
- (2) the traditional hostility of the courts to exclusions (¶6-180—¶6-240), and
- (3) the impact of the *Trade Practices Act* in countering exclusion clauses (¶7-170) and its non-excludable implied warranties in relation to the supply of services (including banking services: ¶7-095).

¶16-041 Code of Banking Practice (1993). The Code of Banking Practice (1993, in force with the agreement of the Commonwealth Treasurer in 1996) sets out standards of disclosure and conduct which banks agree to observe when dealing with their customers.¹² The Code has been undergoing review in 2000.¹³

The aims of the Code of Banking Practice are to promote observance of standards of good banking practice (although the code is not exhaustive of all the issues of good banking practice), to promote disclosure of information to customers, to promote effective relations between bank and customer and to require procedures for resolution of disputes. These are contained in 20 clauses.

Clause 1 contains various definitions, some of which limit the code to an individual and a “banking service” provided by a “bank” wholly and exclusively for the customer’s private or domestic use. The code is then set out in three Parts:

11. TPA sec 52 is re-enacted as ASIC Act sec 12DA; TPA sec 87 is re-enacted as ASIC Act sec 12GM by the *Financial Sector Reform (Consequential Amendments) Act 1998* (Cth), in force 1 July 1998.

12. The Code was one of the recommendations of the Report of the Martin Committee set up to inquire into the effects of deregulation on banks (1991; ¶16-020). The Code parallels the Life Insurance Code of Practice (¶17-036), the

Credit Union Code of Practice (July 1994), the Building Society Code of Practice (October 1994) and the EFT Code of Conduct (revised 1998) (¶16-660). Most banks adopted the code on 1 November 1996, the day the Consumer Credit Code commenced. The code is set out in full at www.bankers.asn.au.

13. Details of the Review are available on the Australian Bankers’ Association homepage at www.bankers.asn.au.

Part A: Disclosure: terms and conditions

Clauses 2-6. These five clauses place various disclosure requirements on banks. The main obligation is to provide customers with written terms and conditions which apply to ongoing banking services. These must meet the requirements relating to legibility, language, etc which are set out in the code, as well as containing the stipulated items for disclosure, where applicable (cl 2). Customers and prospective customers are also entitled to information concerning the interest rates and fees and charges which apply to banking services (cl 4 and 5) and to general descriptive information about these services, including the matters itemised in cl 6.

Part B: Principles of conduct

Clause 7. In their pre-contractual conduct, banks are to have readily available for customers or prospective customers copies of the terms and conditions which apply to their banking services. They must also make timely disclosure of details of fees and charges.

Clause 8. Banks are to provide information on opening of accounts including the identification requirements of the *Financial Transaction Reports Act 1988* (Cth): ¶16-080.

Clause 9. Customers who are affected by variations to the terms and conditions of banking services must be notified of the variation. Some variations require the giving of 30 days' written notice, while others can be notified in writing or by press advertisement no later than the day on which the variation takes effect.

Clause 10. If the bank exercises its right to combine accounts affecting the customer, it must inform the customer promptly.

Clause 11. In the case of foreign currency loans, the bank is to give warnings of risks arising from exchange rate movements and is to advise the customer of mechanisms to limit risks (¶16-060).

Clause 12. The code confirms the bank's legal duties of privacy and confidentiality (¶16-080) and expands the bank's rights to disclose customer information to subsidiary companies and other related entities.

Clause 13. A bank may require a customer to notify it of loss, theft or misuse of the customer's payment instructions.

Clause 14. In the case of deposit accounts (with some exceptions), statements of account are to be available or sent out at least every six months.

Clause 15. When providing credit, the code clarifies that the bank must take into account the customer's capacity to repay.

Clause 16. Banks are to provide information on how joint accounts and subsidiary cards are to be operated.

Clause 17. The amount of liability on a guarantee is to be disclosed and limited to that amount (¶13-360). Certain information must also be provided to the guarantor, some only with the borrower's consent.

Clause 18. Disclosure of full details will be required in bank advertising and promotional material so that it is not misleading or deceptive (§17-250).

Clause 19. Either the bank or a customer may close an account in credit, and the bank retains the right to charge the customer the reasonable costs of closure.

Part C: Resolution of disputes

Clause 20. Banks are to have an internal process for handling a dispute between bank and customer. Banks are also to have an external and impartial process for resolution of a dispute between bank and customer, such as the Australian Banking Industry Ombudsman (§16-045).

Industry codes such as the Code of Banking Practice may be given the force of law under the *Trade Practices Act* sec 51AE, and if so, “[a] corporation must not, in trade or commerce, contravene an applicable industry code” (sec 51AD): §7-500. This has not yet happened with the Code of Banking Practice.

§16-042 Banks and small business principles (1998). The Code of Banking Practice (1993) (§16-041) does not apply to non-consumers but the Australian Bankers’ Association has developed a set of principles entitled *Banks and Small Business Working Together: A Set of Principles*.¹⁴ These are designed to foster good working relations with small business and to encourage a greater understanding of the roles and responsibilities of banks and small business customers. The “Small Business Principles” are as follows (“we” means a bank; “you” and “business” means a small business customer):

- “(1) We will have available information on terms and conditions;
- (2) We will provide notice of variations to Terms and Conditions;
- (3) We may give you documents or notices in writing or electronically or by newspaper advertisement;
- (4) We will respect your rights to Privacy and Confidentiality;
- (5) We will assess an application for financial accommodation in a professional manner;
- (6) We may ask for guarantees;
- (7) We will confirm any changes to your contract;
- (8) We want to build a strong working relationship with you;
- (9) We ask that you take responsibility for advising of problems;
- (10) We may seek from you additional information and/or an independent review;

14. Details of the principles are available on the Australian Bankers’ Association homepage at www.bankers.asn.au.

- (11) We will take care with our advertising;
- (12) We will be timely and courteous in making arrangements to close accounts;
- (13) We will have processes for the resolution of disputes;
- (14) We welcome your comments on this set of Principles.”

These principles apply to small businesses which have up to 15 full time employees, and an annual turnover of up to \$1m or less, and independent ownership (ie they are not a subsidiary of a larger entity, for example).

¶16-045 The Australian Banking Industry Ombudsman.

The Australian Banking Industry Ombudsman Scheme provides a free, independent, alternative dispute resolution scheme for bank customers and, as from 1998, all small business¹⁵ having unresolved complaints involving up to \$150,000.

The Scheme, established in May 1989, was Australia's first private industry ombudsman¹⁶ scheme. It is funded by the member banks in proportion to the number of complaints made against an individual bank, with funding incentives for early resolution of disputes. To ensure the independence and impartiality of the scheme the Ombudsman is appointed and assisted by a Council consisting of an equal number of bank and consumer and community representatives with an independent chair.

Examples of cases considered include credit card disputes, claims of contractual breach, maladministration in lending matters, and misrepresentation. The Ombudsman will not consider disputes which relate purely to a bank's commercial judgment in decisions about lending or security and which do not involve any maladministration.

The Ombudsman resolves disputes on their merits having regard to the law, good banking practice and fairness in all the circumstances. Where appropriate the Ombudsman has the power to investigate a complaint, call a conference of the parties, make a recommendation and, ultimately, make an award which will be binding on the bank provided it is accepted by the customer. If a customer is dissatisfied with the Ombudsman's decision, the customer is free to pursue remedies through the courts. Throughout the process the parties are encouraged to seek to resolve the dispute themselves.¹⁷

15. Before 1998, the scheme applied only to unincorporated small businesses. A fee is payable if detailed consideration of the complaint is necessary.

16. "Ombudsman" was originally a Swedish word meaning "agent or representative (of the people)" or "legal representative".

17. For further details, see the ABIO website at <http://werple.net.au/~abio>.

¶16-050 Duties arising from the contractual relationship.

A number of duties of both customer and financial institution arise from this contract:

Financial institution's duties to customer:

1. To exercise a duty of care in all dealings with accounts (¶16-060, ¶16-070, ¶16-090).
2. To maintain secrecy about its customer's account (¶16-080).

Customer's duties to financial institution: To take reasonable care to see that in the operation of the account the financial institution is not injured (made legally liable), and in particular:

1. To take reasonable care to ensure that the customer's cheques are not stolen or misused (¶16-170).
2. To inform the financial institution if the customer discovers that someone is making wrongful use of the account (¶16-180).

¶16-060 Financial institution's duty to customer. In general terms, the duties of the financial institution to its customer include advice, management, collecting payment of cheques payable to its customer drawn on another financial institution, and the honouring of its customer's cheques (¶16-110). Section 6(2) of the *Cheques Act* gives precedence to certain provisions of the Act by providing that they have effect notwithstanding any agreement to the contrary.¹⁸

Acting honestly may not protect a financial institution from allegations of acting negligently. Recent years have seen substantial increases in the potential liabilities of financial institutions in dealing with their customers, whether under the heading of negligent advice (¶4-230ff), undue influence (¶5-710), unconscionability (¶5-730ff),¹⁹ or misleading or deceptive conduct under sec 52 of the *Trade Practices Act 1974* (Cth).²⁰

— Case example —

Banking and the Trade Practices Act. The applicant company applied for a \$5.4 million loan from the defendant bank for a building development project. The bank's head office approved \$1.45m for the first stage of the development (the acquisition of land), but stressed that this approval was not to be taken as a commitment to the whole development. However, in many subsequent communications by the officers of the company with

18. eg the sections relating to order/bearer instruments, signature, negotiation, indorsement, crossing, presentment, payment in due course and protections relating to financial institutions.

19. eg *Commercial Bank of Australia Ltd v Amadio and Begbie v State Bank of New South Wales*, noted ¶5-730.

20. Compare *Jenkins v NZI Securities Australia Ltd* (1994) ATPR ¶41-349 (offer in financier's letter different from that in facility agreement; refusal to roll over four-year construction finance breached sec 52).

the local branch, the manager and the loans officer did not communicate the reservations of head office and instead made encouraging statements about the likelihood of the bank approving finance for the whole project. After seven months, the applicant learned by direct contact with the bank's head office that the application had been rejected. The Federal Court held that the bank's conduct was misleading and deceptive under sec 52 of the *Trade Practices Act 1974* (Cth) (¶7-280) because the conduct had induced the company to enter into transactions — the principal security and supporting securities, and the land purchase — which it would not otherwise have entered into.

*Adour Holdings Pty Ltd (in liq) v Commonwealth Bank of Australia*²¹ —

Not every dealing between financial institution and customer gives rise to a duty of care, as the parties may be in a relationship of buyer and seller of services subject to the rules of caveat emptor (buyer beware). But if the parties knowingly deal with each other on the basis of a relationship which has a higher degree of trust, confidence and reliance, the financial institution may assume the role of adviser of its customer.²² If so, the financial institution may enter a fiduciary relationship (¶9-770) although the relationship of banker and customer is not one of the accepted fiduciary relationships.²³

Equally, the financial institution may incur other liabilities to its customer such as those under the *Trade Practices Act 1974* (Cth). In the US, bad faith claims have given rise to a body of banking malpractice law called "lender liability" which is setting new standards in defining legitimate conduct in bank/customer dealings.

— *Case example* —

After purchasing a leasehold hotel business, Mr and Mrs P realised that the property had been overvalued. Their bank manager had assumed the role of adviser in relation to the business. Mr and Mrs P alleged that the manager did not disclose his conflict of interest, and, in particular, that his valuation of the business was influenced by the bank's direct interest in the property to ensure that the business was sold at a price to enable loans by the bank to the vendor to be repaid. Mr and Mrs P successfully sued the bank for compensation for breach of the *Trade Practices Act* sec 52 (¶7-280), negligence (¶4-230ff) and breach of fiduciary duty (¶9-770).

Commonwealth Bank of Australia v Smith ²⁴ —

In Australia the term "lender liability" is a description referring to single instances such as those discussed here, rather than a concept known in law.²⁵

21. (1991) ATPR ¶41-147.

24. (1991) ATPR (Digest) ¶46-077.

22. *Potts v Westpac Banking Corporation* [1993] 1 Qd R 135 at p 138 (Full Court, Qld).

25. eg Cranston, R, *Lender liability* (1990) 64 ALJ 653, 732, 789.

23. eg *Golby v Commonwealth Bank of Australia* (1996) 72 FCR 134 at p 136.

Apart from the duty of care applicable to account management and customer dealings, a duty of care can be said to be especially relevant in:

- opening an account (¶16-070);
- maintaining secrecy about customers' accounts (¶16-080);
- payment and collection of cheques (¶16-090).

Foreign currency loans. Deregulation of the Australian financial system in the 1980s, with the abolition of exchange controls on foreign currency, the floating of the Australian dollar and the entry of foreign banks, provided a stimulus to banks' offering foreign currency loans. At first, the 2,000-3,000 foreign currency borrowers benefited from low interest rates and other advantages until the dramatic fall in the Australian dollar in 1985/1986 increased their liability by as much as 100% during the term of the loan.

Many of these borrowers have sued the banks alleging:

- (1) breach of contract (express contractual duty to advise and monitor);
- (2) breach of duty of care in the tort of negligence (¶4-230—¶4-295);²⁶
- (3) breach of the *Trade Practices Act 1974* (Cth) sec 52 (¶7-280);²⁷
- (4) breach of the *Trade Practices Act 1974* (Cth) sec 51AA, 51AB (¶5-755) and the equivalent *Contracts Review Act 1980* (NSW) (¶5-760).

The cases have been decided by reference to the financial sophistication of the borrower, representations alleged to have been made by the lender, and whether hedging and the risks of exchange rate fluctuation had been discussed.

— Case examples —

In the first case decided in favour of a borrower that went to a full hearing (many others have been settled out of court), the court confirmed that the bank was negligent in its failure to advise borrowers of the availability of forward foreign exchange hedging contracts to lock in any foreign exchange loss, and that such duty to advise existed regardless of the borrower's professional qualifications. As the bank had advised that it would monitor the loan, and as a hedge contract should have been put in place, the bank was held responsible for the losses sustained until the expiry of the loan contract because it had consciously involved itself with the plaintiffs over and above a mere agreement to lend money. In short, the bank was found to be in a special relationship of proximity with the borrower and it was in breach of its duty when it failed to act positively by calling in the customer and advising of the immediate necessity of hedging.

_____ *Foti v Banque Nationale de Paris*²⁸ _____

26. eg *Lloyd v Citicorp Australia Ltd* (1986) 11 NSWLR 286 at p 288, per Rogers J (judgment for bank: borrower with commercial and financial background).

¶40-802 (settled on mutually agreeable terms: April 1991); *Andreas Angelatos v National Australia Bank* (1994) ATPR ¶41-333.

27. eg *Westpac Banking Corporation v Eltran Pty Ltd* (1987) 14 FCR 541; (1987) ATPR

28. (No 1) (1989) 54 SASR 354; (No 2) (1989) 54 SASR 433.

In another foreign exchange case, the bank was also held liable to the borrower — this borrower's English was not good, and he had been a long-time and loyal customer of the bank with a relationship of trust in a long line of branch managers. The relevant bank officer had spoken positively about the advantages of a foreign currency loan, had said that there was no significant risk, and that hedging a foreign currency loan was not necessary and was not worth the cost.

_____ *Chiarabaglio v Westpac Banking Corporation*²⁹ —

The bank was also held liable in the case where the borrower had asked the bank officer, "What is the catch?", to which the officer had replied, "There is no catch. It is very much the thing to do."

_____ *Spice v Westpac Banking Corporation*³⁰ —

In contrast, the borrower in a later case failed to establish negligence, breach of contract and misleading or deceptive conduct under the *Trade Practices Act 1974* (Cth) sec 52 in its claim for compensation against its bank. It claimed unsuccessfully that, because foreign currency loans involved unusual dangers compared with traditional forms of bank lending, the bank was negligent in its failure to warn of these unusual dangers. It was also unsuccessful in its claim that, because the bank had special knowledge, it should have pointed out to the borrower other possibilities to reduce the risk of an adverse movement in exchange rates, such as selective hedging, borrowings in a variety of currencies and stop loss orders. On the evidence, there was no reliance to establish proximity between borrower and bank. Even if there had been proximity, the Full Federal Court held the bank not to be in breach of its duty of care because, from the commencement, the branch manager clearly informed the borrower that it could be affected by "adverse currency fluctuations". Indeed, the bank indicated unwillingness to assume responsibility for the foreign currency transaction, as its manager advised the borrower to consult an accountant "well versed in the intricacies of foreign loans". On this recommendation, the borrower had obtained independent advice.

However, on appeal the High Court held that the clause in the parties' loan agreement whereby amounts were paid by the borrower to its bank as "additional amounts" to offset Australian withholding tax on mortgage payments sent to the bank's branch overseas was void under the *Income Tax Assessment Act 1936* (Cth). The case was remitted to the trial judge to determine whether there was evidence of mistake of law: the majority held that payments made under a mistake of law should prima facie be recoverable in the same way as payments made under a mistake of fact (see ¶6-510).

_____ *David Securities Pty Ltd v Commonwealth Bank of Australia*³¹ —

29. (1989) ATPR ¶40-971; appeal dismissed (1991) ATPR (Digest) ¶46-067.

30. Federal Court of Australia, 1 September 1989 (*Foster J*), noted (1990) 5 BLB 181 (judgment for small importer, even though a "reasonably educated borrower"). Appeal dismissed: (1990) ATPR ¶41-024.

31. (1990) 23 FCR 1 (Full Federal Court); (1992) 175 CLR 353 (High Court), noted (1993) 67 ALJ 158, (1993) 67 ALJ 868; later proceedings under the name *Rahme v Commonwealth Bank of Australia* (1994) 68 ALJR 53. This is a major decision rejecting earlier law preventing recovery of moneys paid under mistake of law: ¶6-510; ¶16-160.

Similarly, a foreign exchange borrower was unsuccessful against the bank where it failed to show reliance or dependence on the advice of the bank; the bank had not assumed a duty to manage or monitor the loan and there was therefore no proximity between the borrower and the bank.

——— *Karrawirra Wines Pty Ltd v State Bank of South Australia*³² —

¶16-070 Financial institution's duty of care in opening account. The standard of care expected of financial institutions in opening accounts — and adding new signatories to existing accounts — was raised with the coming into force of the identification requirements of the *Financial Transaction Reports Act 1988* (Cth) in 1991, discussed in ¶16-080. If a financial institution has opened an account and this has led to loss of funds by the true owner, sec 95 of the *Cheques Act 1986* (Cth) may protect the collecting institution from liability to the true owner provided it was not negligent and acted in good faith (¶16-540).

¶16-080 Financial institution's duty of secrecy. The confidential nature of the relationship of bank/customer is very important and, like the solicitor/client, doctor/patient, and accountant/client relationships, leads to a duty to maintain secrecy.³³ Presumably the secrecy laws of bank/customer will apply to dealings of all financial institutions with their customers.

The customer is entitled to expect that its financial institution will keep matters concerning its financial affairs confidential (subject to the four exceptions listed below). Because of its duty of confidentiality at common law, a financial institution does not owe a duty to disclose the business of its customer to a third person:

- A bank owes no duty to disclose to a purchaser from its customer that the customer's business is unprofitable and that the customer owes the bank a substantial sum in relation to that business.³⁴
- A bank owes no duty to inform a builder of the bank's right to refuse further finance to the bank's customer (a building developer) in the event of the customer's default.³⁵

However, these principles would not apply in circumstances where the financial institution was in a fiduciary relationship (¶9-770) with the third person (the purchaser or builder in these examples) as in *Smith's case* (¶16-060).

The duty of secrecy was confirmed in *Tournier's case*:

32. (1994) 62 SASR 1.

33. See further Walter, J McI and Erlich, N, *Confidences — bankers and customers: powers of banks to maintain secrecy and confidentiality* (1989) 63 ALJ 404.

34. *Kabwand Pty Ltd v National Australia Bank Ltd* (1989) ATPR ¶40-950.

35. *Winterton Constructions Pty Ltd v Hambros Australia Ltd* (1993) 39 FCR 97; (1993) ATPR ¶41-205.

— *Case example* —

After P's account with D Bank went into overdraft, P agreed to pay it off by weekly instalments but this arrangement did not work out. His bank manager rang P's employer to ask P's private address and in the course of the conversation informed the employer of the state of P's account and his (the manager's) suspicion that the whole affair was caused by P's recent heavy betting at the races. In consequence of this discussion P lost his job and successfully sued the bank for damages. It was held that the disclosure clearly constituted a breach of D Bank's duty to P because the information disclosed was acquired by D Bank in its capacity of banker to P and during the time of P's account.

—— *Tournier v National Provincial and Union Bank of England*³⁶ —

The duty of secrecy was expressly stated as follows:³⁷

"... At the present day I think it may be asserted with confidence that the duty is a legal one arising out of contract, and that the duty is not absolute but qualified. It is not possible to frame any exhaustive definition of the duty. The most that can be done is to classify the qualification, and to indicate its limits ... I think that the qualifications can be classified under four heads:

- (a) where disclosure is under compulsion by law;
- (b) where there is a duty to the public to disclose;
- (c) where the interests of the bank require disclosure;
- (d) where the disclosure is made by the express or implied consent of the customer."

These qualifications will now be discussed in turn.

(a) *Disclosure under compulsion of law.* The financial institution's duty of secrecy is, or is likely to be, eroded by various statutes:

(1) The *Financial Transaction Reports Act 1988* (Cth). This Act, designed to counter the underground cash economy, tax evasion and the concealment of criminal activity, has three principal objects:

- to "facilitate the administration and enforcement of taxation laws" (sec 4(1));
- to "facilitate the administration and enforcement of laws of the Commonwealth and of the Territories (otherwise than taxation laws)" (sec 4(2)); and
- to make information collected for these purposes available to State authorities for the administration and enforcement of State laws (sec 4(3)).

36. [1924] 1 KB 461; eg Weerasooria, WS, *Tournier turns seventy* (1993) 107 *The Australian Banker* 311; Tucker, G, *Vale Tournier — Salve Privacy Act* (1993) 21 ABLR 290.

37. [1924] 1 KB 461, per *Bankes* LJ at pp 471-473.

The Act fights organised crime and the cash economy by imposing various reporting obligations on business and consumers.

Cash transaction reports: significant cash transactions (Part II). The Act requires a “cash dealer” to report a “significant cash transaction” to the Australian Transaction Reports and Analysis Centre (AUSTRAC) which administers the Act (sec 7). This must be reported within the “reporting period” defined in sec 3 as 15 days for Australian currency, and as the end of the next day if the transaction involves foreign currency. These reporting requirements are designed to identify the money trail of the proceeds of criminal activities and tax evasion.

Cash dealer is defined to include banks, bookmakers and the Totalisator Agency Board (TAB), building societies, casinos, credit unions, currency exchange, insurers, issuers of travellers cheques, and securities dealers and futures brokers (sec 3). A *significant cash transaction* is a transaction involving the physical transfer of coin or paper money of not less than \$10,000.

Information supplied to AUSTRAC is made available to the Australian Taxation Office, the National Crime Authority, Customs and various federal and State law enforcement agencies.

Exempt cash transactions. Section 7 provides three exemptions from the reporting requirement:

- (a) transactions entered on the financial institution’s “exemption register” (sec 7(1)(c)) and transactions between a futures broker and a clearing house (sec 9).
- (b) transactions that are eligible to become exempt transactions during the reporting period (sec 7(1)(d)). The transactions which are eligible for exemption (specified in sec 10) involve financial institutions if they are:
 - between financial institutions;
 - with defined established customers including some retailers and the hospitality industry as defined in sec 10(2)(d)(i);
 - withdrawals for payroll;
 - with public authorities;
 - declared eligible for exemption by the Minister;
 - transfers by established customers from closed accounts at other financial institutions.
- (c) where the cash dealer is an approved cash carrier (sec 7(1)(e)) which maintains records of significant cash transactions (sec 8).

Cash transaction reports: importing and exporting currency (Part II). AUSTRAC also monitors the export of foreign currency from Australia and the import of Australian or foreign currency into Australia of \$10,000 or more by anybody, whether or not a financial institution or cash dealer (sec 15). Anybody who fails to report a transfer of currency or receipt of currency over \$10,000 to AUSTRAC or Customs commits an offence under sec 15

and is liable to up to two years' imprisonment or a fine of up to \$13,200 (for a natural person) or \$66,000 (for a body corporate).

Under amendments made in 1997, bullion sellers must get an identification record for each of their customers before entering into a bullion transaction with them, and must keep it for at least seven years.

Cash transaction reports: solicitors. Under sec 15A, solicitors must report significant cash transactions (ie more than \$10,000) to AUSTRAC.

Cash transaction reports: suspect transactions (Part II). A cash dealer who is party to a transaction which it believes may be "suspect" is required to pass the information to AUSTRAC under sec 16. Suspect transactions are those relevant to an investigation of tax evasion, or an offence against Commonwealth or Territory law, or action under the *Proceeds of Crimes Act 1987* (Cth).

Accounts (Part III). Part III requires a cash dealer to verify the identity of a person operating an account of either (a) \$1,000 or more, or (b) an aggregated sum of \$2,000 or more in the last 30 days.

The account is blocked until the signatory to the account has been identified by one of the following methods:

- the 100 point system (reg 3 and 4);
- the identification reference from an acceptable referee (sec 21);
- a change of name statement (sec 21A); or
- a prescribed special provision (reg 5 to 11).

Additionally, a cash dealer may identify a signatory by a method approved by the Director of AUSTRAC (sec 20A(1)(b)(ii)).

Enforcement (Part V). The Act provides for enforcement in many ways. A cash dealer commits an offence if it does not provide the required or adequate information (sec 28-30). Structuring transactions and transfers to avoid the reporting requirements is an offence (sec 31).³⁸ AUSTRAC may apply for an injunction where there is a breach or proposed breach of the Act (sec 32).³⁹

Amendments made in 1997 provide that it is an offence to provide false or misleading information to a cash dealer when seeking to have funds sent overseas or in receiving funds from overseas.

Implications for business and consumers. The important recording and reporting obligations that the Act imposes affect the confidentiality and privacy of defined business transactions and records.

38. The offence created by sec 31 requires proof of the mental element to commit the crime (the intention — *mens rea* or guilty mind (§12-010)): *Question of law reserved* (No 2 of 1998) (1998) 70 SASR 502.

39. See, eg, Second Reading Speech, *Hansard*, House of Representatives, 13 May 1987, p 3104. See also Comrie, N, *Money laundering in Australia* (1998) 13 BLB 129.

The Act was reviewed by a Senate Committee in 1993 and its reporting objectives upheld. Access to its information by State/Territory revenue authorities was recommended, as was better use of its information by Commonwealth law enforcement authorities. Overall the Act was found to be cost effective and was given a "clean bill of health".⁴⁰

(2) The Proceeds of Crime legislation (1987). Aimed at organised crime, this legislation seeks to deprive those involved of the profits of their crime by tracing, freezing and confiscating criminal profits (¶12-200). To assist in following the money trail and reconstructing transactions, the legislation places a statutory obligation on banks and other financial institutions to retain records (such as those relating to the opening of accounts) for seven years.⁴¹ Cheques over \$200 must also be retained for seven years.⁴²

(3) Taxation, company and trade practices law give wide powers of information-gathering to the Australian Taxation Office,⁴³ the Australian Securities and Investments Commission⁴⁴ and the Australian Competition and Consumer Commission⁴⁵ which override a bank's duty of confidentiality.

(b) and (c) Disclosure where there is a public duty and disclosure where required by the interests of the bank. Exception (b) is undefined by case law but it has been suggested that a banker should not "exercise his private judgment in such matters at the expense of his customer".⁴⁶ An example of exception (c) would be the situation where a bank was suing a customer for the amount of a loan or overdraft; clearly, the state of the customer's account would be disclosed in the writ.

(d) Disclosure by consent of customer. The confidential nature of the financial institution/customer relationship can be breached with the consent of the customer. A person filling in a form for consumer credit or any other form of credit who lists a financial institution reference consents to the financial institution's disclosure of account details, etc to the credit provider upon its inquiry. *Hedley Byrne v Heller and Partners*, based on a banker's reference on creditworthiness, provides important judicial comment on this practice (¶14-240).

40. Senate Standing Committee on Legal and Constitutional Affairs, *Checking the Cash — A Report on the effectiveness of the Financial Transaction Reports Act 1988*, AGPS, 1993. The Act was held to be within the powers of the Commonwealth under sec 51(ii) of the Constitution (¶1-475) in *Leask v The Commonwealth* (1996) 70 ALJR 995.

41. *Proceeds of Crime Act 1987* (Cth) sec 77. Under review: ALRC, *Confiscation that Counts: a Review of the Proceeds of Crime Act 1987*, AGPS, 1999, available at www.alrc.gov.au.

42. *Cheques Act 1986* (Cth) sec 68.

43. *eg Income Tax Assessment Act 1936* (Cth) sec 263-264; *FC of T v Australia and New Zealand Banking Group Ltd (Smorgon's case)* (1979) 143 CLR 499; 79 ATC 4039; ¶15-020.

44. ¶9-380; *eg Corporations Law* sec 876; *Australian Securities and Investments Commission Act 1989* (Cth) sec 33.

45. ¶8-725; *eg Trade Practices Act 1974* (Cth) sec 155.

46. Paget, 3 Legal Decisions Affecting Bankers 312.

Where a customer draws a cheque and there are insufficient funds in the account to cover it, the customer is consenting in a limited way to the financial institution's disclosing information about the customer's account by giving notice to a presenting party that "there are no funds".

¶16-090 Financial institution's duty of care in payment and collection of cheques. As the relationship of financial institution and customer is normally that of debtor (the financial institution) and creditor (the customer), the financial institution is only authorised to make debits to its customer's account with the authority of the customer.

The financial institution's duty of care will be discharged if the necessary standards of care — which can be defined as a subjective standard and as an objective standard — are complied with. The subjective standard is defined in sec 3(2) of the *Cheques Act* (cf ¶16-520):

"(2) A reference in this Act to an act or thing being done in good faith is a reference to the act or thing being done honestly, whether or not the act or thing is done negligently."

The objective standard is defined by the modern and ever-expanding law of negligence (¶4-230ff). In particular, were the circumstances so out of the ordinary that they aroused doubts in the mind of the financial institution so as to put it on notice?

The established standards may in themselves be negligent and what was adequate yesterday may be negligent today (see also ¶4-110—¶4-120).

¶16-100 Drawee institution and collecting institution distinguished. The "drawee institution" (formerly called the *paying bank*) is the financial institution upon which a cheque is drawn by the drawer. When the cheque is presented to it by the payee or the payee's financial institution for "collection", it is paid by the drawee institution.

The "collecting institution" (formerly called the *collecting bank*) is the payee's bank, building society, etc: in other words, the financial institution into which a cheque is deposited for "cashing" or crediting to an account. It is the collecting institution which "collects" payment on behalf of its customer from the drawee institution which is paying the cheque drawn upon it by its customer, the drawer.

Different protections are provided by the Act for drawee and collecting institutions in their areas of potential liability (see ¶16-460—¶16-520; ¶16-540—¶16-550).

¶16-110 Position of drawee institution: (1) to pay cheques. The essential function of the drawee institution is to pay or to honour its customer's cheques. Payment of a debt by cheque operates as payment conditional upon the payment of the cheque on presentation. If the cheque is dishonoured, the debt revives.

Failure to pay a cheque without good reason could be breach of contract, with the drawee institution liable to compensate its customer for all damage flowing from the breach (under the principles discussed at ¶16-420—¶16-440).

A joint account can provide for signing of cheques by any combination of the account holders as contracted with the financial institution. If the account provides only for joint signing of cheques, failure on the part of the drawee institution to honour this contract is actionable by one account holder only, because although the agreement is made with the parties jointly, it is also made with and is enforceable by each account holder separately.⁴⁷

One aspect of the financial institution/customer relationship is that the financial institution borrows from its customer on condition that it will repay the customer, or according to the customer's order, on presentation of instructions (ie a cheque) to that effect. Repayment must normally take place at the branch or office of the financial institution (debtor) where the customer's account is kept.

The drawee institution's function of payment of cheques is subject to certain limitations:

1. There must be sufficient funds in the customer's account, ie the account must be in credit unless an overdraft or other form of credit has been previously arranged with the financial institution. If two cheques are presented simultaneously for payment and the account only has funds to pay one, it should pay to the fullest possible extent — usually the larger.⁴⁸
2. The cheque must be presented during actual business hours.
3. There must be no legal reasons why the cheque cannot be paid. Legal bars include:
 - notice to the financial institution of the customer's/drawer's death (*Cheques Act* sec 90(1)(c)), unless not more than 10 days have elapsed since the notice was received and countermand of payment has not been received from the administrator or a beneficiary of the customer's estate (sec 90(2));
 - notice to the financial institution of the drawer's mental incapacity to incur liability on a cheque (sec 90(1)(b));
 - notice of bankruptcy of the drawer;
 - service of a garnishee order, injunction or other court order restraining the financial institution or the customer/drawer from operating the account;

47. eg *Samsom v Westpac Banking Corporation* (1996) Aust Torts Reports ¶181-383 (no negligence by bank for failure to inquire into cheques drawn by wife on husband and wife joint account).

48. Weaver, GA and Craigie, CR, *The Law Relating to Banker and Customer in Australia*, The Law Book Co Ltd, 2nd ed, 1990, para [12.180].

- notice of winding up or the appointment of a receiver (where the customer is a company);
- a cheque being stale (sec 3(5), 89: ¶16-120), unless the financial institution has agreed with or been directed by the drawer to pay the cheque even though stale (sec 89(2));
- countermand of payment/stop payment (sec 90(1)(a): ¶16-130);
- a cheque being post-dated (sec 16: ¶16-140);
- a forged signature on the cheque (¶16-160).

If the drawee institution does pay a cheque under any of these circumstances it cannot debit its customer's account unless the customer can and does ratify the payment. Any such payment would not discharge the customer's obligations on the cheque because the institution under any of these circumstances has no authority to discharge the obligation. Normally the institution would be able to recover the payment upon the ground of mistake. This is discussed at ¶16-160.

¶16-120 Position of drawee institution: (2) stale cheques.

Section 3(5) of the *Cheques Act* states that “[w]here, at any time, a cheque appears on its face to have been drawn more than 15 months before that time, the cheque is, at that time, a stale cheque”. If the cheque is stale, the drawee financial institution has a discretion to refuse payment of the cheque, subject to an agreement or direction from the drawer to the contrary (sec 89(3), added 1998). This means that under sec 89, the drawer can require the drawee institution to pay or not to pay a stale cheque.

The fact that a cheque is stale does not mean that the drawer cannot be sued on the cheque, since, if an order is made for payment, the drawer will have to direct the drawee institution to pay the cheque.

The 15 months rendering a cheque stale are computed from the date on the cheque rather than its period in circulation or its date of issue; sec 7(2) of the Act conclusively presumes that where a cheque is dated, the cheque is presumed to be drawn on that date.

¶16-130 Position of drawee institution: (3) countermand/stop payment. Section 90(1)(a) of the *Cheques Act* revokes a drawee institution's authority to pay a cheque where it has received a “countermand of payment” (often known as a “stop cheque notice” or a “stop payment”). The section gives no discretion to the institution — it must not debit the customer's account. The customer normally gives instructions by filling in and signing a standard form available from the financial institution.

A countermand will be effective if the cheque can be clearly identified, and if it is communicated to an officer of the financial institution with the necessary legal authority. It will be too late if the cheque has already been paid over the counter, but countermand is possible at any time before close of business where a customer has paid in a cheque drawn on the same branch

of the same financial institution (if not paid). It is also possible where a cheque is presented through the clearing system until the time (defined by the clearing rules) when the drawee institution can return it.⁴⁹

— *Case example* —

A customer of the Commonwealth Bank drew a cheque payable to D on the weekend as a deposit on a car. Changing his mind, he asked his wife to ring the bank on the Monday morning to stop payment. She asked the receptionist to “hold” the cheque until her husband came in later on that day to confirm whether the cheque was to be stopped, but this message was not communicated to the relevant person and it was held that no effective countermand had been given to the bank. When the bank paid the cheque, it tried to recover the amount of the payment under a mistake of fact, but it was held that the mistake in relation to the message was not one between the bank and D, and the bank could not recover the amount of the cheque.

Because the conversation was so ambiguous, in the judge’s view the bank would not have been safe in the circumstances in acting upon the phone message. However, the judgment seems to run counter to the corporate nature of the bank; the customer should have been able to rely on the credentials of the representative to accept the oral authority to stop payment.

———— *Commonwealth Trading Bank v Reno Auto Sales Pty Ltd*⁵⁰ ————

The inability on the part of the bank to recover the proceeds of the cheque from the third party would not have prevented the customer from suing the bank for negligence or conversion if the stop payment had been held to be effective and if the customer’s account had been debited with the amount. It is doubtful if a financial institution could protect itself from breach of sec 90(1)(a) of the *Cheques Act*; and it is suggested that an attempted limitation of liability clause would be no more than an ineffective exclusion clause (see ¶6-180ff).

— *Case example* —

Customer A stopped payment of its cheque by notifying its bank (the paying bank, CBA). Payee B’s bank (the collecting bank, ANZ) proceeded to collect payment for B, and was later unable to recover payment from CBA — alleging breach of the clearing rules — (on the ground that the dishonoured cheque had been returned too late), or from the payee, because (1) the payment was not made under mistake of fact as ANZ knew that CBA was seeking to recover the amount; (2) ANZ was the agent for payee B and was able to recover from B only until the time the cheque was returned dishonoured, and (3) ANZ was able to make available the proceeds of uncleared cheques to its customers even though “proceeds of cheques etc unavailable until cleared”. Paying bank CBA was entitled to

49. Cranston, R, *Countermand* (1989) 63 ALJ 549.

50. [1967] VR 790; *Commercial Bank of Australia Ltd v Younis* [1979] 1 NSWLR 444.

reimbursement from ANZ under the clearing house rules, leaving the loss on collecting bank ANZ.

*Commonwealth Bank of Australia Ltd v
ANZ Banking Group Ltd*⁵¹ —

A financial institution which overlooks a customer's stop payment notice and pays a stopped cheque mistakenly is entitled to recover the money from the payee as money paid under a mistake of fact (§5-620ff; §6-510; §16-160) unless the payee in good faith has acted in reliance on the payment. If the cheque was not crossed and was negotiable, and is transferred from payee B to third person C, C can enforce it against A if C is a holder in due course, even if A has stopped payment (§16-360). If the cheque were crossed "not negotiable", C could not enforce the cheque as C would not be a holder in due course.

¶16-140 Position of drawee institution: (4) post-dated cheques. Post-dated cheques can provide a useful breathing space for a drawer. The drawer can issue the cheque and forward date it to the date funds are to be deposited into the account; or the drawer can issue a post-dated cheque as a security for a loan, for example, with the forward date being the date of the loan's repayment.

The *Cheques Act* clarifies earlier doubts under the *Bills of Exchange Act* that a post-dated cheque was not a cheque because it was not payable on demand, and provides that, "for the purposes of determining whether a post-dated instrument is a cheque, the fact that the instrument is post-dated shall be disregarded" (sec 16(3)). Hence, all the rights, liabilities and protections of a cheque apply to a post-dated cheque.⁵²

The drawee institution has no mandate to pay until the date arrives, and it must either hold the cheque until its date arrives, or run the risk of damages for wrongfully paying it before its date. A cheque is not duly presented for payment to the institution (§16-320) before its date arrives (sec 61(2)), and the institution's duty under sec 67(1) to either pay it or dishonour it "as soon as is reasonably practicable" cannot arise until or after the date of the cheque. The drawer is not liable on the cheque until it is duly presented for payment (sec 58).⁵³

¶16-150 Position of collecting institution. In collecting payment for its customer from the drawee institution, there is an agreement, express or implied, that the proceeds of the cheque will be credited to the customer's account. This means that the collecting institution acts as agent of its customer for collection of cheques from the drawee institution. If the

51. Supreme Court of NSW, 1987, unreported, noted (1989) 63 ALJ 424.

52. See further, Edwards, R, *The conundrum of the post-dated cheque* (1999) 14 BLB 111.

53. Section 131 of the Consumer Credit Code prohibits payment for goods or services by post-dated bills of exchange which exceed the cash price.

customer is indebted to the financial institution, it is a holder for value (§16-360). In either situation, the financial institution has a general possessory lien over its customer's cheques and bills of exchange for amounts owing (§13-250).¹

¶16-160 Position of drawee institution or collecting institution: recovery of payment made by mistake or on a forgery. A financial institution (drawee or collecting) which does pay a cheque, telegraphic transfer, or electronic transfer without authority, or on a mistake of fact or a mistake of law,² can generally recover (eg in restitution (§6-510)) the proceeds from the person to whom they were paid. The lack of authority may have been due to any of the legal reasons justifying non-payment noted above, such as the death of the customer, the cheque being stale, countermanded, forged, etc (for example, a cheque containing an unauthorised or forged signature is "wholly inoperative" under sec 32 of the *Cheques Act* (subject to some exceptions: ¶16-370, ¶16-480)).

Paying without the customer's mandate does not authorise the drawee institution to debit the customer's account. This is the cause of the institution's need to recover the proceeds of the cheque from the third party.

— *Case example* —

Chisholm owed Jakes Meats \$14,158. He went to his local ANZ branch and organised for the amount to be telegraphically transferred to Jakes' Westpac account. By clerical error, the ANZ clerk telegraphically transferred \$114,158 to Westpac, \$100,000 too much. ANZ picked up the mistake three days later and immediately notified Jakes' Westpac branch, but Westpac said there was little it could do about the overpayment as it had already credited Jakes' account. At the request of ANZ, Jakes did start to repay, but Jakes went into liquidation after only \$2,500 had been repaid to ANZ. ANZ claimed from Westpac the \$97,500 still owing by Jakes, on the basis that Westpac had been on notice of ANZ's mistake. However, Westpac's liability to refund was limited to some \$17,000 plus interest, the amount remaining after drawings by its customer before it received notice from ANZ of its error. "The basis of the common law action of money had and received for recovery of an amount paid under fundamental mistake of fact should now be recognised as lying not in implied contract but in restitution or unjust enrichment" (§6-510). ANZ's remedy would be against Jakes.

— *Australian and New Zealand Banking Group Ltd v Westpac Banking Corporation*³ —

1. eg *National Australia Bank Ltd v KDS Construction Services Pty Ltd (in liq)* (1987) 163 CLR 668; (1987) 62 ALJR 63. Proceeds of customer's bills of exchange held by bank under lien can be set-off by bank against customer's debt to the bank: *Duke Finance Ltd (in liq) v Commonwealth Bank of Australia* (1990)

22 NSWLR 236, noted (1992) 3 JBFLP 41; §13-250; §16-360.

2. As supported by the High Court in 1992 in the *David Securities case*, §6-510.

3. (1988) 164 CLR 662 at p 673; (1988) 62 ALJR 292 at p 295, noted (1989) 63 ALJ 41.

¶16-170 **Customer's duty to draw cheques carefully.** As the relationship of financial institution and customer is normally that of debtor (the financial institution) and creditor (the customer), the financial institution is only authorised to debit its customer's account with the authority of the customer, with two qualifications:

- (1) The customer has a duty to the financial institution to take usual and reasonable care in drawing a cheque to prevent a fraudulent alteration of it which may cause loss to the financial institution.
- (2) The customer also has a duty to inform the financial institution of any forgery as soon as the customer becomes aware of it, discussed at ¶16-180.

With reference to the first duty, case law supports the "narrow" duty of care of the customer to *prevent* forgery,⁴ and rejects the earlier "wider" duty of care of the customer to *detect* forgery.⁵

— *Case example* —

The firm of A1 and A2 employed C as its clerk, book-keeper and cashier. One of C's duties was to fill in cheques for the signature of A1 or A2. On the day in question, C presented a blank cheque for £2 to A2 for signature, saying it was for petty cash. To this cheque, C added two extra digits, a "1" and a "0", the words "one hundred and twenty pounds" and made the cheque payable to "Ourselves". The cheque was paid by the firm's bank to C who absconded with the proceeds. A1 and A2 sued the bank in negligence and claimed the excess debit of £118. The bank could not be held liable for debiting the customer's account because in the circumstances the firm had been guilty of breach of a duty to take reasonable and ordinary precautions against forgery in drawing a cheque. It was the lack of precaution which caused the loss (A2 who signed the blank cheque was in a hurry to leave the office at the time; the partners were experienced business people). (Section 91 of the *Cheques and Payment Orders Act 1986* (Cth) now also protects a bank paying an improperly raised cheque in good faith and without negligence: ¶16-485.)

— *London Joint Stock Bank Ltd v Macmillan and Arthur*⁶ —

The *Sydney Wide* case in 1981 confirmed that the duty of care of the customer is the "narrow" duty of care. The drawee institution's application to the High Court concerned only the preliminary point to the actual claim

4. Narrow duty of care to be taken by customer to prevent forgery. Customer liable: *Young v Grote* (1827) 4 Bing 253; 130 ER 764; *London Joint Stock Bank Ltd v Macmillan and Arthur* [1918] AC 777; *Commonwealth Trading Bank of Australia v Sydney Wide Stores Pty Ltd* (1981) 148 CLR 304; (1981) 55 ALJR 574; *National Australia Bank Ltd v Hokit Pty Ltd* (1996) 39 NSWLR 377.

5. Wider duty of care on customer; stricter duty of care on bank to detect forgery. Bank liable: *Colonial Bank of Australasia Ltd v Marshall* [1906] AC 559; *Varker v Commercial Banking Co of Sydney Ltd* [1972] 2 NSWLR 967.

6. [1918] AC 777.

of the customer, namely, whether the drawee institution could validly raise as a defence the drawer's own negligence in drawing the cheque.

— *Case example* —

Cheques payable to "Computer Accounting Services" (B) were often drawn "Pay CAS or order" by the relevant staff of the drawer, A. An employee of A added an "H" to the cheques in question to make them read "Pay CASH or order" and they were paid by the paying bank. The cheques were crossed "Not negotiable" and the words "A/C Payee Only" added.

A sued its bank, the paying bank, and was met with the defence of its own negligence. In particular the paying bank alleged by way of negligence:

- the fact that the cheques were drawn payable to CAS, rather than to "C.A.S." (with full stops) or to Computer Accounting Services, thereby facilitating fraud;
- failure to detect the fraud of its employee.

The High Court upheld the bank's defences and confirmed that the duty of the customer is to take usual and reasonable care in drawing a cheque in order to prevent a fraudulent alteration of it which may cause loss to the bank.

*Commonwealth Trading Bank of Australia v
Sydney Wide Stores Pty Ltd*⁷ —

In giving effect to modern developments of duties of care in tort and contract, the High Court recognised that the duty of care of the customer cannot be absolute. The court refused to place a heavy burden (ie the "wider" duty) on the customer other than to impose the requirement of the exercise of care to prevent forgery when drawing a cheque. Failure to do so would lead to responsibility on the customer's part for any loss if it was caused by the customer's careless drawing of a cheque which in fact led to the forgery.

In placing the primary responsibility to detect forgeries on the bank (the drawee institution), rather than on the customer to prevent them, the court placed some of the burden of loss on the banking system. As one of the judges noted:

"If in practice, the losses, which to individual bank customers would be onerous, are cumulatively only slight for the banking system in comparison with the vast amount of business done by cheque, a sensible system of loss spreading would be to continue as before"⁸ (ie under the *Macmillan* principle).

This clearly renders the negligent drawer liable, but does not impose a high standard of care upon the drawer.

7. (1981) 148 CLR 304; (1981) 55 ALJR 574; discussed at (1981) 55 ALJ 823 and further by Coleman, CF, *Negligence in drawing cheques — Commonwealth Trading Bank of Australia v Sydney Wide Stores Pty Ltd* (1981) 9 ABLR 376.

8. *Commonwealth Trading Bank of Australia v Sydney Wide Stores Pty Ltd* (1981) 148 CLR 304, per *Murphy J* at p 317.

— *Case examples* —

Between 1972 and 1978 an accounts clerk employed by bank customer P forged the signature of the managing director (an authorised signatory) on some 300 cheques purportedly drawn on three banks totalling some \$HK5.5m. An express term of P's banking contracts was that P would notify the banks of errors in bank statements, and that in the absence of notification, the statements would be deemed confirmed or correct. The forgeries went unnoticed by all but the accounts clerk, and were only detected when a newly appointed accountant commenced reconciling bank statements with P's books after the last of the forged cheques had been honoured. P sought a court declaration that the banks had wrongly debited the accounts. The Hong Kong courts upheld the bank's argument that P was in breach of a duty of care owed to the banks to take reasonable care to ensure the proper working of P's accounts, and in particular that it was a necessary condition of the banker/customer relationship that P would take reasonable care to ensure that in the operation of P's accounts the banks would not be injured. However, the Privy Council on appeal found for P, and applying *Macmillan's case* (above) and *Greenwood's case* ¶16-180) confirmed that the only duties owed by P to its banks — in the absence of an express agreement to the contrary — were:

- (1) a duty to refrain from drawing a cheque in such a manner as to facilitate fraud or forgery, and
- (2) a duty to inform the bank of any unauthorised cheques purportedly drawn on the account as soon as P (the customer) became aware.

— *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd*⁹ —

Mrs Banno, the bookkeeper of several family companies (P), signed her employer's name, with his knowledge, on several company cheques for company purposes. She also signed his name, without his knowledge, on some company cheques for herself. P was successful in suing its bank (the paying bank (now called the drawee institution)) for debiting moneys to its account without its authority. The New South Wales Court of Appeal followed the *Sydney Wide case* and the *Tai Hing case* and held that a customer is not under a duty to take reasonable care to prevent forged cheques being presented for payment.

— *National Australia Bank Ltd v Hokit Pty Ltd*¹⁰ —

These two cases confirm that the customer is *not* under a duty to the financial institution (unless the financial institution has imposed such requirements):

- (1) to take reasonable care to prevent the presentation to the drawee institution of forged cheques. The *Hokit case* rejected the drawee institution's defence that it was unjust that it should bear the burden

9. [1986] AC 80; [1985] 2 All ER 947, noted, eg, (1986) 60 ALJ 238; Hicks, S, *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank*

& Ors: *an examination* (1986) 11 Syd LR 162.

10. (1996) 39 NSWLR 377.

of forged cheques — when it has little or no possibility of detecting the forgery.

- (2) to check financial institution statements so as to notify the financial institution of any unauthorised debits.

¶16-180 Customer's duty to disclose forgeries. The second duty of the customer is to inform the financial institution if aware that the customer's signature has been forged. By notification at the earliest opportunity, the customer protects the financial institution, which is carrying out responsibilities on the customer's behalf in paying the cheque upon which it could later be liable for unauthorised payment/conversion/negligence. If the customer fails to warn the financial institution, an estoppel may be raised.

— *Case example* —

In an eleven-month period, P's wife forged her husband's signature on 44 order cheques drawn on his account, payable to her name or to a name similar to hers. The cheques purported to be indorsed by the drawees and were presented to the bank for payment by P's wife or another woman who was not definitely identified. By not speaking up, P's silence amounted to a representation that the cheques were not forgeries and P was estopped from recovering from the bank.

— *Greenwood v Martins Bank Ltd*¹¹ —

The consequence of this duty — to inform the financial institution of forgery of which the customer is aware — raises the issue of whether the financial institution must report the forgery to the police. Forgery is a criminal offence, and any "deal" offered by the customer to the financial institution to "keep it quiet" renders the financial institution liable for prosecution for misprision of felony or possibly as an accessory after the fact. This is the concealment of the commission of a felony. At one stage it was believed that the offence was obsolete but its existence was confirmed by the courts in Australia in 1991.¹² The exact limits of the offence are unclear. For example, can non-disclosure of an offence be justified on grounds of privilege similar to those recognised by the law in the case of lawyer/client, etc (see ¶16-080)? If a financial institution manager had been told by a customer that a certain cheque had been forged by the customer's son but that the customer intended to deal with the matter personally and did not intend to claim on the financial institution, would the financial institution manager be entitled not to report the forgery? The authors of *Banker and Customer in Australia* expect a "yes" answer in the event of prosecution of the manager for misprision, but the situation may have changed since the coming into force of the *Cheques Act 1986* (Cth), because a forged signature could be ratified by the customer under sec 32 to make it "good" (¶16-370).¹³

11. [1933] AC 51, ¶16-480.

12. *Petty v The Queen* (1991) 173 CLR 95.

13. *Weaver and Craigie, op cit*, para [13.810], [13.830].

CHEQUES

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¶16-190 Regulation of cheques. Cheques have long been accepted as an essential part of everyday life. Business and domestic budgets are (or were) based on the paper record provided by payment by cheque. The statistics have shown a dramatic increase in the number of cheques drawn to some 1,000 million per annum in the 1990s, although the impact of electronic banking (¶16-650—¶16-670) may well see further increases curtailed.

The British *Bills of Exchange Act 1882* (UK) was the precedent for the law governing cheques in Australia, the other British Commonwealth countries and the United States. Superseding the Australian colonial Acts of the nineteenth century, the *Bills of Exchange Act 1909* (Cth) regulated cheques until the *Cheques and Payment Orders Act 1986* (Cth) was passed.

Reform and update of the law of cheques was recommended in 1964 by the Manning Committee appointed by the federal government (¶16-020). The Committee's most important recommendation was that there should be separate legislation dealing with cheques to overcome confusion with the law of bills of exchange.¹⁴

Despite limited amendments to the *Bills of Exchange Act* in 1971, no substantial action was taken until a draft *Cheques Bill 1984* was released in 1984 for public comment. Following a lengthy public consultation period with relevant legal and industry associations, a revised *Cheques Bill 1985* was introduced into the federal Parliament in 1985.¹⁵

Further consultation led to major amendments to the *Cheques Bill* during 1986 with the incorporation of the provision for payment orders to be issued by non-bank financial institutions in their own names. The amended Bill was retitled the *Cheques and Payment Orders Bill 1986* (Cth), which, 22 years after the originating Report of the Manning Committee came into operation in 1987.

The *Cheques and Payment Orders Act 1986* (Cth):

- created a new negotiable instrument then called a payment order issued

14. *Report of the Committee appointed by the Commonwealth Government to review the Bills of Exchange Act 1909-1958* (the Manning Committee), Canberra, 1964.

15. *Hansard*, House of Representatives, 22 May 1985, p 2909; *Hansard*, Senate, 18 September 1985, p 723.

by non-bank financial institutions (NBFIs, such as building societies and credit unions);

- simplified and standardised crossings (sec 53-57: ¶16-390—¶16-450);
- provided that where there are inconsistent amounts written on a cheque, the lesser or least amount is to operate (sec 15(2));
- extended the period before which cheques become stale from 12 months to 15 months (sec 3(5): ¶16-120);
- provided that the collecting bank could present cheques to the paying bank by transmitting particulars without physically moving them: sec 62;
- provided for the presentment of cheques at “a designated place” (sec 62) (such as the processing centre of the bank on which the cheque was drawn) as an alternative to presentment at the home branch of the cheque (see ¶16-330).

The *Cheques and Payment Orders Act* did not regulate EFTS (see ¶16-650ff).¹⁶

The *Cheques and Payment Orders Act 1986* (Cth) underwent major changes in 1998 partly in line with the recommendations of the Wallis Report (¶16-020). The 1998 amendments were designed to:¹⁷

- advance the principles of competitive neutrality in the financial sector;
- enhance transparency in the payments system by making clear which financial institution stands behind a cheque; and
- facilitate the provision of cheaper and more efficient financial services to consumers, especially those in rural and regional Australia.

The *Cheques and Payment Orders Amendment Act 1998* (Cth), passed on 25 June 1998 and in force from 1 December 1998:

- changed the name of the legislation from *Cheques and Payment Orders Act 1986* (Cth) to *Cheques Act 1986* (Cth);
- extended the range of financial institutions on which a cheque may be drawn to include (in addition to a bank) building societies, credit unions and their industry Special Service Providers (SSPs)¹⁸

16. eg shortcomings considered in Edwards, R, *The Cheques and Payment Orders Act 1986 — congenital defects* (1992) 66 ALJ 586; Edwards, R, *Common misconceptions about cheques* (1993) 67 LIJ 1173.

17. Hansard, Second Reading Speech, House of Representatives, 8 April 1998; see eg Weerasooria, W, *Legislation to amend settlement in the payments system and cheques and payment orders* (1998) 13 BLB 123.

18. The Financial Institutions Code provides for the registration as an “SSP” of a body which provides financial services to institutions registered under the financial institutions legislation such as building societies and credit unions. Special Service Providers may, for example, specialise in treasury management, receiving deposits, or investing and providing loans.

- repealed the little-used provisions relating to payment orders drawn on non-bank financial institutions;
- made a number of amendments to the Act such as:
 - amending the definition of an order cheque (§16-250);
 - removing the capacity to convert a bearer cheque to an order cheque (§16-250);
 - giving the discretion to a drawee institution to pay a stale cheque (§16-120);
 - providing for the clearing of cheques by non-bank financial institutions (as well as banks) (§16-330); and
- removed the need for “agency cheques”. By issuing agency cheques drawn on a bank, non-bank financial institutions had been able to provide cheques for their members and therefore access the payments system. The *Cheques and Payment Orders Act* had regularised “agency cheques” by ensuring that the non-bank financial institution’s liability as the drawer of an agency cheque was transferred to the customer if the customer signed the cheque (former sec 100). As all financial institutions can now issue cheques, agency cheques will no longer be needed.¹⁹

The *Cheques and Payment Orders Amendment (Turnback of Cheques) Act 1998* (Cth) has also amended the *Cheques Act 1986* (Cth) by providing that in the event of the insolvency of a drawee institution, unsettled cheques will be deemed to be dishonoured and the collecting institution can reverse provisional credits with the “turnback” of the cheque to the customer, who will have to seek payment from the drawer or indorser (§16-330).

§16-200 Legal definition of a cheque. Section 10(1) of the *Cheques Act* states that:

“A cheque is an unconditional order in writing that—

- (a) is addressed by a person to another person (being a financial institution);
- (b) is signed by the person giving it; and
- (c) requires the financial institution to pay on demand a sum certain in money.”

“Financial institution” is defined in sec 3(1) to mean:

- “(a) the Reserve Bank of Australia; or
- (b) a bank within the meaning of the *Banking Act 1959*; or
- (c) an FIC institution; or
- (d) a person who carries on State banking within the meaning of paragraph 51(xiii) of the Constitution; or

19. Agency cheques can still be issued by non-bank financial institutions which are

not regulated by the Financial Institutions Code.

- (e) a person (other than a person referred to in paragraph (a), (b), (c) or (d) who carries on the business of banking outside Australia.”

An “FIC institution” is a building society, credit union or Special Service Provider which is subject to the Financial Institutions Code.

It is the practice of financial institutions to issue standard-form printed cheques. However, there are no statutory or case law rules to the effect that a cheque cannot be written on a sheet of note paper, an egg, a cow,²⁰ or anywhere else with the permission of the financial institution. Of course, restrictions on the use of other than the financial institution’s own printed cheque form may be imposed by the institution itself as a condition of the financial institution/customer contract, such as: “Cheques should be drawn only on the Bank’s printed form and written in ink.”²¹

A cheque has characteristics which make it more than a “chose in action” (¶13-040) and more than a “piece of paper” held by the payee against the drawer, because under the *Cheques Act* there is a contract between payee and drawer.²²

¶16-210 Advantages of cheques. As part of everyday business and life, cheques have a number of sometimes unrecognised advantages:

- (1) They provide a ready substitute for cash.
- (2) They avoid the risk of theft or loss, especially as a forgery is inoperative (¶16-370).
- (3) They can be posted or delivered with ease and security.
- (4) They can be drawn to the exact amount owing.
- (5) They provide a convenient record of payment of debt.
- (6) Because financial institutions’ books and books of account are admissible as evidence in the courts, copies of entries — ie dates of payment of cheques, etc — may be received as evidence both of the entries and of the transactions recorded in them.

(Compare bills of exchange at ¶16-560.)

20. Reported in the fictitious case *Board of Inland Revenue v Haddock; Rex v Haddock*, reported in Herbert, AP, *Uncommon Law, being 66 misleading cases revised and collected in one volume*, Eyre Methuen, 1979, p 201: “The Negotiable Cow”.

21. As to the enforceability of this “condition” in contract law, see *Burnett v Westminster Bank Ltd* [1966] 1 QB 742; [1965] 3 All ER 81: such a condition is only enforceable

if it can be shown to be agreed upon at the opening of the account. It must comply with the exclusion clause rules (set out at ¶16-180ff).

22. *Parsons v The Queen* (1999) 73 ALJR 270 at p 277, referring to *Cheques Act 1986* (Cth) sec 25, 71, 76 and 116, noted Weerasooria, W, *High Court on cheques as “property” in criminal law* (1999) 14 BLB 89.

¶16-220 Differences between cheques and bills of exchange.

The main differences between cheques and bills of exchange are as follows:

- (1) A cheque is only drawn on a financial institution, which gives rise to the main distinction between a cheque and a bill of exchange, ie the financial institution/customer relationship upon which a cheque is based.
- (2) Cheques are generally used for local transactions and bills of exchange for overseas trading operations.
- (3) Cheques are drawn on a financial institution and payable on demand; days of grace as allowed to the drawee of a bill of exchange are not applicable.
- (4) Bills of exchange cannot be crossed (¶16-390).
- (5) A bill of exchange is “accepted” by the party upon whom it is drawn (¶16-595).
- (6) A cheque must be presented for payment before it is stale (¶16-120) whereas a bill payable on demand is deemed to be a continuing security.

For further discussion of bills of exchange, see ¶16-560—¶16-596.

¶16-230 The face of the cheque

A's DRAWEE INSTITUTION		11-11-00
PAY	<u>Payee B</u>	OR BEARER
THE SUM OF	<u>Ten dollars</u>	\$10.00
2121972	<u>A</u>	DRAWER

There are a number of basic definitions concerning the face of a cheque: The *drawer* (person A) is the person “writing” or “issuing” the cheque to payee B. The drawer does not negotiate the cheque to B. (B negotiates the cheque to third person C: ¶16-260.) It is the drawer’s account upon which the cheque is drawn.

The *payee* (B) is the person to whom the proceeds of the cheque are or will be paid. The payee is the person to whom the cheque is payable.

The *drawee* is the “person” upon whom the cheque is drawn, ie the drawer’s financial institution — the drawee institution.

As an extra precaution, and to reduce the impact of fraudulent alterations, sec 15(4) of the *Cheques Act* provides that a cheque can be expressed to require the payment of a sum not exceeding a specified amount, such as “sum not to exceed \$x”.

¶16-240 Concept of negotiability. The idea of negotiability — transfer of ownership by delivery or indorsement so that the transferee may get better title than the transferor — is a major exception to ordinary rules of ownership.²³ It is not defined in the *Cheques Act* or its predecessors perhaps because the earlier words “bill” and “note” meant negotiability.

A negotiable instrument is, to start with, an “instrument” or document containing an obligation (usually) to pay money. Good legal title to this instrument passes from payee B to the transferee C if taken in good faith and for good consideration (by delivery: bearer cheque (¶16-250; ¶16-270); or by delivery and indorsement: order cheque (¶16-250; ¶16-280)). The title of transferee C is then free of any defects or equities which might have affected the title of the transferor.

To avoid the consequences of negotiability — A or B having to pay holder in due course C or D — financial institutions advise their customers to “protect yourself or your payee by using the words ‘not negotiable’ between parallel lines”. The “not negotiable” crossing prevents negotiation (¶16-420). Because most cheques are collected for payee B and are not negotiated to third party C, should they no longer be negotiable instruments?²⁴

CHEQUES PROCEDURE _____

Types of cheques ¶16-250
Negotiation of a cheque ¶16-260
Negotiation of a bearer cheque ¶16-270
Negotiation of an order cheque ¶16-280
Indorsement ¶16-290
Payment of a cheque ¶16-320
Clearing of cheques ¶16-330

¶16-250 Types of cheques. Section 20 of the *Cheques Act 1986* (Cth) provides that all cheques are payable either to bearer or to order.²⁵ This distinction is crucial in following the progress of the cheque and the rights of the later parties to it.

Bearer cheque. Included in the category of bearer cheques are:

- cheques expressed to be payable to or to the order of bearer (sec 22);
- cheques expressed to be payable to or to the order of a payee specified in the cheque or to bearer (sec 21, 22); and
- cheques expressed to be payable to a fictitious or non-existing person (“Superman”), to an impersonal thing or to the purpose for which

23. “*Nemo dat quod non habet*”: see ¶3-270. 25. This carries forward the same distinction in the *Bills of Exchange Act 1909* (Cth) sec 8, 13(2).
24. *Should cheques be negotiable instruments?* (1993) 67 LJ 252.

the cheque is drawn (“cash”, “cash or bearer”, or “cash or order”) (sec 19, 22).²⁶

Examples: Pay B or bearer
Pay cash or order
Pay Superman or bearer.

Because a cheque is a negotiable instrument, if it is payable to the “bearer” it is therefore payable to the person who has it (the “holder”); it does not matter whether this person has any right to the cheque or not, or whether the person found it or even stole it. But to have the strongest enforceable rights over the cheque, the bearer must qualify as a “holder in due course” (¶16-360), which means that the bearer must have come by the cheque:

- (1) in good faith,
- (2) for value and
- (3) with no notice of any defect in the title of the person who negotiated it to the bearer (sec 50(1)(b)).

This would exclude thief C or finder C of a bearer cheque from being able to sue the drawer A upon it if A dishonoured the cheque. Therefore the bearer’s rights to sue upon the cheque would come second to the right of drawer A to stop payment. In these circumstances bearer C could not enforce the cheque.

A holder can enforce a cheque but cannot take the cheque free of equities: ¶16-360.

The 1998 amendments repealed former sec 23, which had allowed a holder to convert a bearer cheque into an order cheque. Former sec 23 raised uncertainties for the collecting bank receiving such an order cheque as it would not have had a chain of indorsements to link the customer back to the original payee.

Order cheque. The *Cheques Act*, developing the distinction made in sec 20 between cheques payable to order and cheques payable to bearer, makes in sec 21 the initial distinction that an order cheque is one that requires of the financial institution payment:

“... to or to the order of, and only to or to the order of—

- (a) a person specified in the cheque as payee or indorsee; or
- (b) 2 or more persons specified in the cheque, jointly or in the alternative, as payee or indorsee.”

The 1998 amendments have clarified the meaning of “to or to the order of” and have confirmed that an order cheque cannot be expressed to be payable to bearer (sec 3(1A)):

26. eg Luntz, H, *Cheques payable to impersonal objects* (1989) 63 ALJ 36.

“(1A) For the purposes of this Act, a cheque is payable *to or to the order of* a person or persons if:

- (a) it is expressed to be payable:
 - (i) to the person or persons; or
 - (ii) to the order of the person or persons (or to words to that effect); or
 - (iii) to the person or persons or to the order of the person or persons (or words to that effect); and
- (b) it is not also expressed to be payable to bearer.”

The *Cheques Act* defines cheques which are regarded as payable to order, and regards all others as payable to bearer.

Examples: Pay B
 Pay B or order
 Pay bearer (B Smith) or order.

Crossing out the words “or bearer” on a pre-printed bearer cheque converts a bearer cheque to an order cheque.

¶16-260 Negotiation of a cheque. Negotiation refers to the transfer of a cheque from payee B to transferee C or from finder/thief C to another person, person D, to become a “third party cheque” (see below). For a bearer cheque, negotiation requires delivery (sec 40(3)); for an order cheque, it requires indorsement and delivery (sec 40(2)).

Negotiation, as explained in sec 40(1) of the *Cheques Act*, is the transfer of the cheque from the holder to another person D with the result that the transferee becomes entitled to it as “holder” (¶16-360). Under sec 50(1), holder D is a “holder in due course” if the cheque is not crossed “not negotiable”, if it was transferred by negotiation to the holder, and if the holder took the cheque in good faith, for value, etc (¶16-360).

As provided in sec 39, *every* cheque may be transferred by negotiation until it is discharged — whether or not it is crossed “not negotiable”. A “not negotiable” cheque cannot be negotiated free of the claims of earlier holders (sec 55): ¶16-420.

Negotiation does not refer to the ordinary delivery of a cheque from drawer A to payee B: this is called the issuing of a cheque (“issue” is defined in sec 3) and it does not make payee B a holder in due course. But payee B does not need the fact of “negotiation” before B has the right to sue on a cheque, because a cheque is deemed to be evidence in itself of the right to sue.

Third party cheques. When a cheque is negotiated by payee B to third party C (for a bearer cheque, by delivery; for an order cheque, by indorsement and delivery), it is called a “third party cheque”. The responsibilities of the collecting institution when third party C wishes to deposit B’s cheque into C’s account are discussed at ¶16-540.

¶16-270 Negotiation of a bearer cheque. Negotiation of a bearer cheque does not require indorsement, and a bearer cheque is negotiated just by handing it over (by delivery²⁷) from payee B to third person C so long as it is not crossed “not negotiable”: ¶16-420.

Payee B is described as the “transferor by delivery” (sec 77). This section expressly states in subsec (2) that a transferor by delivery B is not liable on the cheque, but, under subsec (3), the transferor is liable to the immediate transferee C, if transferee C is a holder for value (sec 37: ¶16-360), for breach of the following warranties:

- “(a) that the cheque is what it purports to be;
- (b) that the transferor by delivery has the right to transfer the cheque by negotiation; and
- (c) that the transferor by delivery is not, at the time of the transfer, aware of any fact that renders the cheque valueless.” (sec 77(3)).

This means that the transferor by delivery B promises only the immediate transferee C that the cheque will be paid in due course. In contrast, the indorser of a cheque promises to pay the immediate indorsee C or any later indorsee D, etc (¶16-350).

¶16-280 Negotiation of an order cheque. Negotiation of an order cheque takes place on the indorsement of the holder completed by delivery (sec 40(2)). Delivery is defined widely in sec 3 to mean “the transfer of possession of the cheque from one person to another” — presumably this includes both actual and constructive delivery. It is the question of indorsement in the context of order cheques on which attention must be focused.

¶16-290 Indorsement. Indorsement is the procedure required to negotiate an order cheque from payee B onwards. (A bearer cheque can also be indorsed, but if it is indorsed the indorser faces liability to the indorsee and later indorsees: ¶16-350. A bearer cheque is normally negotiated by delivery, and the transferor by delivery of a bearer cheque is liable only to the immediate transferee: ¶16-270.) An indorsement must be “written” or placed on the cheque and signed by the indorser”, and must be an “indorsement of the entire cheque” (sec 41(1)(b)). A mere signature on a cheque, without additional words, is sufficient as an indorsement (sec 41(3)); an indorsement may be in pencil, and it may be either on the back or the front of the cheque. If the payee or indorsee is wrongly designated on the cheque or their name is misspelt, they may indorse the cheque in accordance with the wrong designation or spelling, but if they do so they must also add their proper signature (sec 44).

27. Defined in sec 3 as “the transfer of possession of the cheque from one person to another”.

— *Indorsement examples* —

<i>Cheque payable to</i>	<i>Correct indorsement</i>
CCH Examples Limited	{ CCH Examples Limited B Smith Secretary
Smith and Brown	{ Smith and Brown A Smith
Paula S Lawrence	Paula S Lawrence or { Paula S Lawrence PS Lawrence
Joan Brown (now married to Michael Smith)	Joan Smith nee Joan Brown
Mrs Smith	J Smith
Mrs Joan Smith	Joan Smith
Mrs Michael Smith	{ Mrs Michael Smith Joan Smith

Conditional indorsement. A cheque may contain a conditional indorsement such as “Pay B on attaining membership of the Australian Society of CPAs”. This is effective under sec 45, whether or not the condition is fulfilled, and it does not prevent holder C from becoming a holder in due course (§16-360).

The liability of the indorser is set out in §16-350.

§16-320 Payment of a cheque. The whole purpose of the use of the cheque is, of course, payment. Payment refers to the last stage of its progress when it is honoured by the financial institution upon which it is drawn.

A holder of a cheque may demand payment from drawer A’s financial institution (the drawee institution) on or after the date it bears. When the cheque is paid, it is called by the Act “payment in due course” and is defined in sec 79 of the *Cheques Act* as payment at any time to the “holder in good faith and without notice of any defect in the holder’s title”.

Discharge of an open *bearer* cheque takes place with payment to the person in possession, even if that person stole or found the cheque. Although the bearer who has stolen or found the cheque is not legally the “holder in due course” and does not have the right to sue to enforce the cheque, that person is still the “holder” and as such may be entitled to be paid (as noted also at §16-360). Payment by the financial institution may not involve it in liability (depending on the face of the cheque and the care to be exercised by the collecting institution: §16-540—§16-550) because it is doing no more than honouring its customer’s instructions.

Discharge of an open *order* cheque takes place with payment to the payee or indorsee who is in possession of it. A person holding an order §16-320

cheque under a forged or unauthorised indorsement has no right to the instrument under sec 32 (§16-370); a financial institution honouring such a cheque will face liability to the true owner in conversion (see §4-020; §16-460) and no payment in due course will have taken place.

— *Case example* —

An envelope containing drawer A's cheque (an uncrossed order cheque) was stolen from payee B's post office box at the Adelaide GPO. B had therefore not been paid because until the cheque is received by the payee (personally or by an agent), the risk of loss is with the drawer.

— *D & J Fowler Ltd v French*²⁸ —

¶16-330 Clearing of cheques. When a cheque is paid by the collecting institution or is paid by the recipient into the payee's account, it is conditionally credited to that account. ("Cheques not available until cleared" is a familiar notice, and an established condition of the financial institution contract: §6-100.)

The collecting institution then presents the cheque for payment to the drawee institution through the cheque clearing process.²⁹ A cheque may be presented in the ordinary course, or it may be presented for a "quick clearance" or a "special answer", and in either case, the drawee institution must either pay it or dishonour it promptly unless there is a legal reason not to pay such as the bankruptcy of the drawer.³⁰

The cheque can be presented physically — or electronically by exhibiting it "by any other means" (see 62(2)) — to the drawee institution's "proper place" or its "designated exhibition place".³¹

Truncation. The *Cheques Act* provides for truncation of cheques — the cheque can remain at the collecting institution for clearing while its details are forwarded electronically to the drawee institution.

Turnback. The *Cheques and Payment Orders Amendment (Turnback of Cheques) Act 1998* (Cth) added new sections to the *Cheques Act* to provide for the "turnback" of cheques on failed financial institutions (sec 70A-70B). This provides that if a drawee institution becomes insolvent, the collecting financial institution can treat unsettled cheques as dishonoured, reverse the provisional credits made to the customers' accounts and "turnback" the

28. [1914] SASR 254. In contrast to the "postal acceptance rule" in contract (§5-330), there was no evidence to show that the post office was B's agent.

29. The Australian Payments Clearing Association Ltd is owned by Australia's banks, building societies and credit unions. Its rules for bulk electronic clearing of payments including cheques were authorised by the then TPC (now the ACCC) on public benefit grounds (§8-660): *Australian Payments Clearing Association Ltd* (1994) ATPR (Com)

¶50-164; earlier proceedings noted TPC Bulletin, No 71, p 41 (1993).

30. Sec 67. See, eg, *Jet Fuels Petroleum Distributors Pty Ltd v Australia & New Zealand Banking Group Ltd* (1993) 115 FLR 134.

31. Sec 62(1). The "designated exhibition place", to be specified in the *Gazette* (sec 65), includes the drawee institution's data processing centre. See further Raisin, R, *The clearance system: an insider's view* (1999) 13 Commercial Law Quarterly 14.

cheques to their customers. This means that customers will have to get payment from the drawers or indorsers of the cheques, and the drawers will have to prove in the winding up of the insolvent financial institution.³²

LIABILITY OF PARTIES ON THE CHEQUE _____

Liability of the drawer ¶16-340
Liability of the indorser ¶16-350
Holder, holder for value and holder in due course ¶16-360
Forgery ¶16-370
Estoppel in cases of forgery ¶16-380

¶16-340 Liability of the drawer. A basic proposition of law — as noted at ¶6-190 — is that you are responsible for what you sign.³³ In the context of cheques, liability is of two kinds: liability as drawer, and liability as indorser.

Section 71 of the *Cheques Act* states that a *drawer* “undertakes” that, on presentment (¶16-330) to the drawer’s financial institution, the cheque shall be paid “according to its tenor as drawn”. Moreover, if it is dishonoured, the drawer undertakes to compensate the holder or an indorser who is compelled to pay it. By sec 70:

“A person who is the drawer or an indorser of a cheque that has been dishonoured is liable on the cheque whether or not the person is given notice by any person of the dishonour.”

Section 17 confirms that A is liable on the cheque by preventing the drawer from limiting or negating liability. Certainly the drawer can waive the right to presentment expressly (sec 17(1)) or by implication (sec 59(b)(ii)), but this does not cancel liability on the cheque. An agent signing a cheque as drawer or indorser may be liable on the cheque (sec 33(2)): ¶11-320.

¶16-350 Liability of the indorser. The indorser (B) promises the indorsee (C) and later indorsees that the cheque will be paid by the drawer (A), the person with the primary responsibility for the cheque. The indorser and drawer are jointly and severally liable to the holder that the cheque will be honoured and paid (ie, both parties are treated as having made one single promise, and each is also taken to have contracted individually with the

32. This complements the changes in the *Payment Systems and Netting Act 1998* (Cth). See, eg, Avram, K, Edwards, R and Love, R, *Failure in the payments system — new legislation* (1998) 14 BLB 23.
33. And a person (including a company) is taken to sign a cheque or other instrument

if the person’s signature is written or placed on it (eg by stamp or by mechanical means) “by another person with or under the first-mentioned person’s authority”: *Cheques Act 1986* (Cth) sec 114. It may be a criminal offence to knowingly pass a valueless cheque: eg *Crimes Act 1900* (NSW) sec 178B; *Summary Offences Act 1953* (SA) sec 39.

holder).³⁴ If the cheque is not paid, the holder can enforce payment from drawer or indorser.

The indorser can negate its liability by writing the words “no liability” or “without recourse” after the indorsement (sec 17(2)).

Section 75 of the *Cheques Act* compounds this situation by providing that where a person signs a cheque other than as drawer or indorser and intends to become liable on it, the Act applies to that person as if an indorser.³⁵ For example, a cheque drawn by a company may be “backed” by the director personally signing it, which has the effect under sec 75 of rendering the director liable as indorser.

¶16-360 Holder, holder for value and holder in due course.

The *Cheques Act* distinguishes holder, holder for value and holder in due course.

A *holder* is defined in sec 3 to mean:

- “(a) in relation to a cheque payable to order — the payee or an indorsee who is in possession of the cheque as payee or indorsee, as the case may be; and
- (b) in relation to a cheque payable to bearer — the bearer”.

A holder includes, therefore, the payee, the indorsee or bearer — “value” need not be given to make a person a holder. Without “value”, a mere *holder* of a bearer cheque is any person in possession such as a recipient (eg a clerk), donee or finder. In contrast, the only holder of an order cheque is the payee or indorsee. Under sec 49(1), the holder can sue in the holder’s own name (although this right to sue is unlikely to be enforceable because of the defences open to the other parties to the cheque).

A *holder for value* as defined in sec 37 indicates the addition of the presence of “value” or consideration. Consideration for the purposes of the *Cheques Act* is consideration according to contract law principles (sec 35(1)(a): ¶5-400—¶5-500), expanded by the statement that valuable consideration may be constituted by “an antecedent debt or liability” (sec 35(1)(b)). This actually widens the contract law meaning and overcomes the result that at common law the giving of a cheque for an amount already owed would be no consideration because the obligation is past and already incurred (¶5-410). Where value has been given — at any time (sec 37) — the holder will be deemed to be a holder for value. The cheque can only be enforced by the holder for value and, unless there is valuable consideration, action by the holder will be unlikely to succeed. The payee or holder cannot enforce payment against a financial institution where there is a failure of consideration.

34. Compare the “joint and several liability” of partners in tort (¶10-270) and of supplier and credit provider in consumer credit law (¶14-210).

35. With the exception of *Cheques Act* sec 25, 26, 27, 28(2).

— *Example* —

A cheque drawn by A is negotiated by payee B to C, then to D and E in succession with consideration for each. E gives the cheque to F as a gift. As against C and D, F is the holder for value and can sue. As against E, F is not the holder for value and has no right to sue E.

When collecting payment of cheques, the collecting institution is an agent for collection. If the customer is indebted to the financial institution, the institution is a holder for value. If the customer is not indebted to the financial institution, the institution is a “mere” agent for collection and not a holder for value.³⁶

Hence the holder has good title but perhaps cannot sue; the holder for value has good title and can sue; but both categories still take “subject to equities”. If there is a prior defective title the importance of the category “holder in due course” becomes apparent.

The *holder in due course* is person C, D or later. Payee B is a holder, but not a holder in due course as the cheque is “issued” by A to B, not negotiated from A to B. The holder in due course is the bona fide purchaser for value without notice of any defect in transferor C’s title and becomes the owner free of equities (sec 49(3)). The holder in due course “holds the cheque free from any defect in the title of prior indorsers (ie B or C) as well as from mere personal defences available to the drawer (ie A) and prior indorsers (ie B or C) against one another” (sec 49(2)(a)).

Section 50 states that to qualify as a holder in due course:

- (1) the cheque must have been negotiated from payee B to C (¶16-240) — by delivery if a bearer cheque (¶16-270) or by indorsement if an order cheque (¶16-280—¶16-290);
- (2) the cheque must be complete and regular — eg there must be no discrepancy between words and figures, indorsements must be in order and there must be nothing out of the ordinary about it;
- (3) the cheque must not be stale (over 15 months old): sec 3(5) (¶16-120);
- (4) the cheque must not be crossed “not negotiable”: sec 53, 55 (¶16-420);
- (5) the holder must take the cheque in good faith, ie honestly even if negligently: sec 3(2);
- (6) the holder must give valuable consideration for the cheque; and
- (7) the holder must have no notice of:
 - (a) dishonour of the cheque; or
 - (b) B’s having no title to the cheque, or any defect in B’s title, such

36. *Duke Finance Ltd (in liq) v Commonwealth Bank of Australia* (1990) 22 NSWLR 236 at pp 247-249; ¶16-150.

as the cheque having been obtained by unlawful means such as fraud (sec 32: ¶16-370), duress, or illegal consideration: sec 3(3); or

- (c) transfer of the cheque by B to C in breach of faith, or “under circumstances amounting to a fraud”: sec 50(2).

¶16-370 Forgery. A forged signature on a cheque will be wholly inoperative except as provided for by sec 32 of the *Cheques Act*. Section 32(1) states:

“Where a signature is written or placed on a cheque as that of the drawer without the authority of the person whose signature it purports to be (in this subsection referred to as the “relevant person”), the signature is wholly inoperative as that of the relevant person unless—

- (a) the person against whom it is sought to assert a right on the cheque is estopped from denying the genuineness of the signature or the existence of authority for the signature, as the case requires; or
- (b) the signature is ratified or adopted by the relevant person,

but the signature operates as the signature of the person who wrote or placed it on the cheque in favour of any person who, in good faith and without notice that it had been written or placed on the cheque without the authority of the relevant person, pays the cheque or takes the cheque for value.”

The similarly worded sec 32(2) applies where the unauthorised signature is placed on the cheque otherwise than as that of the drawer.

At common law, forgery is the making or alteration of a writing to the prejudice of another person's rights. Forgery is also an offence under all the Australian criminal statutes.³⁷ For example, in the words of the *Crimes Act 1900* (NSW) sec 250:

“‘Forging’ means the counterfeiting, or altering in any particular, by whatsoever means effected, with intent to defraud, of an instrument, or document, or of some signature, or other matter, or thing, or of any attestation, or signature of a witness, whether by law required or not to any instrument, document, or matter, the forging of which is punishable under this Act.”

A person denied title to a cheque because of forgery is not without remedy. That person has redress against the immediate transferor, the forger, parties liable on the instrument after the forgery, and the person whose signature was forged if that person is estopped from denying the validity of the signature.

In accordance with the provisions of sec 32, and subject to other sections of the Act, a forgery will be “good” in the following circumstances:

37. *Crimes Act 1914* (Cth) sec 63-69; *Crimes Act 1958* (Vic) sec 252ff; *Crimes Act 1900* (NSW) sec 250-298; *Criminal Code 1995* (Qld) sec 182; *Criminal Law*

Consolidation Act 1935 (SA) sec 212ff; *Criminal Code* (WA) sec 473; *Criminal Code* (Tas) sec 277ff; *Criminal Code* (NT) sec 258ff.

- Where the person against whom it is sought to assert a right is estopped from denying the validity of the signature (sec 32(1)(a); 32(2)(a)).
- Where the forged signature is ratified or adopted by the relevant person. (Forgery being a crime, does the person ratifying become an accessory after the fact in criminal proceedings?)
- Where an indorser is estopped from denying the validity of the indorsement (sec 74).
- Where a financial institution is given statutory protection against the consequences of paying or collecting payment for a forged cheque (sec 92, 93(2), 94, 95(1), 95(3)): ¶16-490—¶16-540.
- Where a person who, in good faith and without notice that the signature had been written or placed on the cheque without the authority of the person whose signature it purports to be, pays the cheque or takes the cheque for value. In this case the signature operates *as the signature of the person who wrote or placed it on the cheque* (sec 32(1) and (2)).

¶16-380 Estoppel in cases of forgery. Estoppel is a rule precluding X from denying the truth of a statement made by X or the existence of facts which X has by words or conduct led Y to believe in. Where Y has acted upon the representation, X is “estopped” from denying the truth of the representation (for “promissory estoppel” see ¶5-485). In the cheques context, estoppel may be of two kinds:

- (1) estoppel by negligence, (¶16-170; ¶16-480), or
- (2) estoppel by omission (¶16-180).

CROSSINGS ON CHEQUES _____

The object of crossing a cheque	¶16-390
Crossings on cheques	¶16-400
Non-permissible crossings	¶16-410
Not negotiable crossing	¶16-420
Not negotiable crossing: cases and examples	¶16-430
Account payee instruction	¶16-440
Account payee instruction: cases and examples	¶16-450

¶16-390 The object of crossing a cheque. A cheque need not be crossed — an uncrossed cheque is called an open cheque. The object of crossing is to prevent negotiation to an unauthorised person, by providing that the proceeds of the cheque should be paid by the drawee institution to the collecting institution as agent of the holder. A crossing therefore places extra responsibility on to the payee institution (¶16-490—¶16-500). Greater protection is given to the person entitled to the cheque than if the cheque were uncrossed or open. The *Cheques Act* recognises only two classes of crossing:

- general crossing (sec 53(1)(a): ¶16-400);
- not negotiable crossing (sec 53(1)(b): ¶16-420—¶16-430).

The Act has technically abolished the distinction formerly contained in the *Bills of Exchange Act* between “general crossings” and “special crossings” and limits statutory crossings to those of sec 53. However, because the *Cheques Act* has not actually prohibited other instructions and crossings on the face of a cheque, such non-statutory crossings continue to operate in the financial institution/customer contract as:

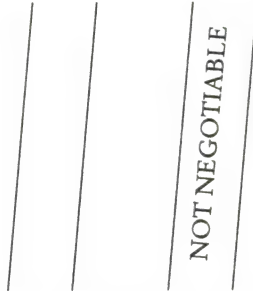
- non-permissible crossings (¶16-410);
- the account payee instruction (¶16-440—¶16-450).

¶16-400 Crossings on cheques. Section 53(1) of the *Cheques Act* states that a cheque is crossed when it bears across its face the addition of:

- two parallel transverse lines, or
- two parallel transverse lines with the words “not negotiable” between, or substantially between, the lines.

The Act is definite when it states, in sec 53(2), that nothing else on the face of a cheque is effective as a crossing (but it does not prohibit the use of other words and it does not affect any other operation that the words may have).

— *Examples of crossings* —



The lines must be parallel and accordingly a one-line crossing thus: / does not constitute a crossing, but nor does it cancel the cheque or annul it. The drawee institution would be protected if it cashed the cheque (sec 93: ¶16-500). It may be under a duty, in compliance with its duty of payment in the ordinary course of business (sec 94 noted at ¶16-520), to inquire of its customer, the drawer, whether such a mark was intended as cancellation of the cheque.

A crossing on a cheque does not affect its transferability by negotiation (sec 39(3)); ¶16-420.

¶16-410 Non-permissible crossings. Although the *Cheques Act* authorises only a general crossing (¶16-400) and a not negotiable crossing (¶16-420—¶16-430), it does not actually prohibit on the face of the cheque

other crossings or other directions to the financial institution. It is arguable that the financial institution is not able to totally disregard words on a cheque comprising such non-statutory crossings, or in the words of the government, a “non-permissible crossing”,³⁸ and to that extent the following, formerly valid as crossings under the *Bills of Exchange Act*, continue to operate as valid instructions to the financial institution. Because these examples are not authorised crossings, they will not require the two parallel transverse lines which are the essence of a crossing.

Examples (1), (2) and (3) are perhaps all obsolete.³⁹ Their origin lies in the necessity in the days of the early Lombard Street Clearing House of ensuring collection by a bank clerk on behalf of his employer bank and served as a direction to the paying bank to ensure collection by a bank. As protection to the payee, the crossing makes payment to a finder or thief more difficult and certainly ensures easier tracing if payment is made.

— *Examples of instructions to the financial institution* —

(1)	(2)	(3)	(4)	(5)	(6)	(7)
BANK	AND CO	AND CO BRISBANE	PAY ... BANK FOR COLLECTION	UNDER \$100	A/c PAYEE ONLY	WESTPAC PERTH

The effect of these non-permissible crossings, in essence, is the instruction by drawer A to A’s drawee institution to ensure that payment is made only to a bank (examples (1)-(7)).

Examples (5) and (6) contain words in addition to the crossing which are of some concern to the drawee institution: if a cheque for over \$100 were presented for payment (example (5)), it would be the duty of the drawee institution to check with its customer (A) before paying the cheque, or it would run the risk of action in conversion by A if A’s account were debited contrary to A’s instruction. In other words, sec 94 would not protect the drawee institution which could not plead that it had paid the cheque “in the ordinary course of business”.

38. *Explanatory Memorandum on Cheques Bill 1985*, Circulated by Authority of the Deputy Prime Minister and Attorney-General, Canberra, 1985, para 250 (now admissible as evidence under

sec 15AB of the *Acts Interpretation Act 1901* (Cth): ¶11-550); Bostock, TE and Turner, JC, *Transferability of cheques and crossings* (1985) 1 BLB 60.

39. Manning Committee, 1964, *op cit*, para 62.

Example (6), on the other hand, does not concern the drawee institution, because how can it tell for whom the cheque is being collected (B? C? or D?) by the payee/indorsee's financial institution? The addition of the name of a financial institution across the face of the cheque by the drawer/indorser, as in example (7), formerly constituted a "special crossing" under sec 82(2) of the *Bills of Exchange Act*. Its status under the *Cheques Act* is as a valid instruction to the drawee institution (eg under contract) to pay only through the account of the financial institution specified.

¶16-420 Not negotiable crossing. A cheque can be crossed by adding clearly across the front two parallel transverse lines with or without the words "not negotiable" between (or substantially between) them (sec 53(1)). Nothing else, such as writing the words "not negotiable" without the lines, constitutes a crossing (sec 53(2), (3)).

If a cheque is crossed "not negotiable" it can still be "negotiated" in the sense that it can still be transferred (sec 39). If it is a bearer cheque, negotiation is by delivery (sec 40(3)); if it is an order cheque, negotiation is by indorsement and delivery (sec 40(2)): ¶16-260.

The concept of "negotiability" means generally that if transferee D takes the cheque in good faith and for good consideration, D qualifies as "holder in due course" (under sec 50: ¶16-360) and gets good title free of any defects or equities which might have affected the title of transferor C. The "not negotiable" crossing stops this happening by restoring the *nemo dat* rule that one cannot give what one does not have: ¶3-270. A "not negotiable" cheque does not have the quality of negotiability (¶16-240), and a person taking the cheque takes it subject to defects in title.

Legal title to a cheque crossed "not negotiable" cannot pass by negotiation free of defects or equities affecting the title of the transferor C (sec 55). Transferee D cannot become a holder in due course (sec 50(1)(a)(iii): ¶16-260), and will have to repay the true owner (¶16-540), drawer A or payee B.

The other important effect of crossing is that the drawee institution will only pay the crossed cheque by depositing the amount in an account with a financial institution (sec 54). If it does not do this and, for example, cashes the cheque over the counter, the financial institution may be liable to the true owner of the cheque for any loss suffered.

¶16-430 Not negotiable crossing: cases and examples. Different effects may follow the use of the "not negotiable" crossing, according to the particular circumstances.

— *Example* —

A draws a cheque payable to B and crosses it "not negotiable". C steals the cheque from B and negotiates it to D for value. D is the loser: if A stopped payment of the cheque, D could do nothing; even if A's financial institution paid D, D would still be liable to A or B (whichever is the "true owner") to refund the proceeds. D's remedy is against C.

In this example, the application of sec 55 of the *Cheques Act* means that as C's title is that of a thief, and because D cannot acquire title better "than that which the person he took it from had", D's title remains equivalent to that of a thief. In other words, as expressed by *Griffith CJ* in 1914:

"... the words 'not negotiable' on a crossed cheque are a danger signal held out before every person invited to deal with it, and are equivalent to saying 'Take care: this cheque may be stolen'."¹

— *Case example* —

A partner in a real estate firm (A) gave his secretary (C) a signed blank cheque crossed "not negotiable". C was to fill it in for £2 and to make it payable to the Commissioners of Inland Revenue as payee (B). Instead of doing this, C filled it in for £54 and made it payable to one of her own creditors, the defendant (D). When the cheque was paid, A (as owner of the cheque) was held entitled to recover the amount of the cheque from D.

— *Wilson and Meeson v Pickering*² —

The effect of the English equivalent of sec 55 was that the secretary (C) had "no title to the cheque and, accordingly, in the very words of the section the defendant [creditor] did not have a better title than [the secretary]". Counsel for the defendant attempted to show that this was a case of "estoppel by negligence", meaning that the firm would be liable because the partner had enabled the secretary to fraudulently fill in the cheque, if any detriment suffered by an innocent defendant could be shown. It was said that signing the cheque in blank did not constitute negligence because it was crossed "not negotiable", meaning that it was not transferable by delivery to any taker. It was held therefore that as the "not negotiable" crossing operated to restrict the cheque, it also restricted any liability which might have flowed from signing the cheque in blank.

¶16-440 Account payee instruction. The words "account payee" are well recognised in and by bank practice. However, they are not recognised as a statutory crossing under the *Cheques Act* although their use is not actually prohibited by the Act. Their effect is as follows:

- The "account payee" instruction has nothing to do with the drawee institution, and this institution's only obligation is to comply with the transverse parallel lines which make up a valid crossing under sec 53(1)(a) (¶16-400) and therefore to pay the cheque only through an account to another financial institution.
- The "account payee" instruction, when added by the drawer or indorser, constitutes an effective instruction to the collecting institution to ensure that the proceeds of the cheque, when collected from the drawee

1. *Commissioners of State Savings Bank of Victoria v Permevan, Wright & Co Ltd* (1914) 19 CLR 457 at p 467.

2. [1946] KB 422 at p 429.

institution, are to be applied to the credit of the payee.³ The words also have the status of a “non-permissible crossing”, discussed at ¶16-410.

If the collecting institution pays the cheque into an account of a person other than the named payee without first making inquiries of the drawer, it could run the risk of paying the cheque to an unauthorised person. In such a case it would not have the benefit of sec 95 as a defence to an action in conversion by the true owner (noted at ¶16-540). The words therefore impose a real obligation on the collecting institution and place a heavy onus on it to disprove negligence if it collects for a person other than the true owner.⁴

¶16-450 Account payee instruction: cases and examples.
The effects of marking a cheque “account payee” are illustrated by the following case example.

— *Case example* —

The case of the fraudulent clerk. A finance company acceptance officer, who was an authorised signatory of company cheques, was able to create non-existent clients and draw cheques for non-existent transactions supposedly with his employer finance company. The officer was able to milk cash from the company by paying the cheques back into the finance company’s account in substitution for cash and to ensure that the books would balance. As the cheques were order cheques crossed “not negotiable account payee only”, one question which arose when the finance company sued the bank to recover the losses it had suffered was the effect of the “account payee” crossing. As the cheques seemed to be indorsed by the “customer”, clearly there was nothing irregular to put the bank on inquiry and there was nothing to indicate that the bank was in breach of its contractual duty to its customer. Payment was not being sought by someone who was not the payee, and the indorsement was apparently regular, and in favour of and being received for the credit of the drawer. In these circumstances the “account payee” crossing had no role to play.

— *Universal Guarantee Pty Ltd v
National Bank of Australasia Ltd*⁵ —

The effect of the “account payee crossing” (now a non-permissible crossing: ¶16-410) and authorised crossings was set out by the Privy Council in this case in the following words:

“... [the court] must state briefly the effect of crossings on a cheque, well understood though it may be ...

3. eg *Akrokerri (Atlantic) Mines Ltd v Economic Bank* [1904] 2 KB 465 at p 472; [1904-07] All ER Rep 1054. Payee does not mean holder at the moment, but the named payee: *House Property Co of London Ltd v London County and Westminster Bank Ltd* (1915) 84 LJKB 1846.

4. eg Gillooly, M, *The “account payee” crossing after the Cheques and Payment Orders Act 1986* [1987] AT Article No 19 ACL 36077.

5. (1965) 65 SR (NSW) 102 at p 106; [1965] 2 All ER 98 at p 102.

(1) A crossing means that the paying bank paying the cheque to a banker in good faith and without negligence has the protection of [the precursor to sec 92 of the *Cheques Act*: ¶16-490].

(2) The words 'not negotiable' do not prevent the cheque from being negotiated but mean that the holder of the cheque cannot have, and is not capable of giving, a better title to the cheque than that of the holder from whom he obtained it [sec 55 of the *Cheques Act*: ¶16-420].

(3) The addition of the words 'a/c payee' or 'a/c payee only' refer to the payee named in the cheque and not the holder at the time of presentation,^[6] but they do not prevent, at law, the further negotiability of the cheque. The words merely operate as a warning to the collecting bank [now financial institution] that if it pays the proceeds of the cheque to some other account it is put on inquiry and it may be in a difficulty in relying on any defence under [sec 95] of the Act in an action against it for conversion of the cheque. ^[7] These words do not cast on the paying bank [now drawee institution], paying the cheque to a banker, any additional obligation to satisfy itself that the collecting bank is collecting it on behalf of the named payee. That is entirely the responsibility of the collecting bank."

The instruction does not prevent the transferability of the cheque by payee B to a third party C (see 39): but how is a collecting institution to respond when presented with an order cheque crossed "Account B" which is indorsed on the back "Pay C, B"? In this case, the collecting institution clearly does not collect for the named payee. Indeed, its instructions conflict. Various possibilities are open to the collecting institution to guard itself against action in conversion and loss of its sec 95 defence: to make inquiries if suspicious circumstances exist; or to refuse to collect payment of the cheque (and therefore breach its responsibility to its customer of collection of cheques duly lodged for payment).

PROTECTION TO THE DRAWEE INSTITUTION ____

Protection from what?	¶16-460
The drawee institution and legal liability	¶16-470
Estoppel of customer	¶16-480
Section 91: protection of drawee institution	
paying improperly raised cheque	¶16-485
Section 92: protection of drawee institution paying	
crossed cheque in accordance with crossing	¶16-490
Section 93: protection on payment of crossed cheques ...	¶16-500
Section 94: protection on payment of unauthorised,	
absent or irregular indorsements	¶16-510

6. *House Property Co of London Ltd v London County & Westminster Bank Ltd* (1915) 84 LJKB 1846.

7. *AL Underwood Ltd v Bank of Liverpool* [1924] 1 KB 775 at p 793.

Payment of cheque “in good faith and without negligence” ¶16-520

¶16-460 Protection from what? When a financial institution pays a cheque, it is the financial institution’s money which is paid and the financial institution then debits the customer’s account. If the account is debited without the customer’s authority, the customer might sue the financial institution for negligence (tort), breach of contract, the tort of conversion (¶14-020) and restitution (¶16-510).

¶16-470 The drawee institution and legal liability. The law provides a number of defences to a drawee institution if sued by the true owner of a cheque for any mishandling of the cheque. Such mishandling may involve legal action in conversion (tort), negligence (tort), breach of contract and/or restitution (¶16-510), although defences may be available in the following circumstances:

- sec 32: estoppel of customer (¶16-480);
- sec 91: drawee institution paying improperly raised cheque (¶16-485);
- sec 92: drawee institution paying crossed cheque in accordance with crossing (¶16-490);
- sec 93: drawee institution paying crossed cheque (¶16-500);
- sec 94: drawee institution paying unauthorised, absent or irregular indorsements (¶16-510).

¶16-480 Estoppel of customer. It may well be the customer’s negligence which has led the drawee institution to wrongful payment of a cheque. If this is the case, the drawer may be estopped from denying liability both at common law and under sec 32 of the *Cheques Act* which provides that an unauthorised (including a forged) signature is wholly inoperative unless there is estoppel or a subsequent ratification (¶16-370). Further, the principle set out in sec 32 restricts the operation of:

- sec 92, which protects a drawee institution paying a crossed cheque in accordance with its crossing (¶16-490);
- sec 93, which protects a drawee institution paying a crossed cheque otherwise than in accordance with the crossing (¶16-500);
- sec 94, which protects a drawee institution paying a cheque with an unauthorised, absent or irregular indorsement (¶16-510).

The duty owed by the customer to the financial institution encompasses both the exercise of reasonable care in the drawing of cheques and notification to the institution upon discovery of any forgeries.⁸

8. *Greenwood v Martins Bank Ltd* [1933] AC 51, ¶16-180.

¶16-485 Section 91: protection of drawee institution paying improperly raised cheque. A drawee institution has no authority to debit its customer's account if there is a fraudulent and material alteration by a holder of the cheque, and could face liability to its customer for acting without authority. A fraudulent employee arguably holds the excess of a fraudulently raised cheque drawn by the employer (the customer) in trust (¶9-755) for the collecting institution (if it is not entitled to debit the customer's account). The excess is held in trust for the customer (if the financial institution is entitled to debit the account). However, the excess is not held in trust for the customer if the financial institution has suffered loss from the improperly raised cheque.⁹

Section 91 provides protection to a drawee institution acting "in good faith and without negligence" which pays to the holder a cheque which has been "fraudulently altered so as to increase the sum ordered to be paid by the cheque" (see ¶16-170). The protection provided by sec 91 only applies where the fraudulent alteration to increase the sum is the only material alteration of the cheque made fraudulently.

¶16-490 Section 92: protection of drawee institution paying crossed cheque in accordance with crossing. A drawee institution is in no position to investigate the genuineness of a person presenting a cheque for collection, and its chief obligation is owed to its customer, the drawer of the cheque. A crossing (¶16-390—¶16-450) placed on a cheque must be complied with by the drawee institution (as must any of the instructions now called non-permissible crossings: ¶16-410), but sec 92 of the *Cheques Act*,¹⁰ to be read subject to sec 32 (¶16-370; ¶16-480), relieves the drawee institution from potential legal liability to its customer so long as it pays a crossed cheque to another financial institution in good faith and without negligence. Such payment is deemed to be payment in due course.

"Protection of drawee institution paying crossed cheque in accordance with crossing"

92 Subject to subsection 32(1), where the drawee institution, in good faith and without negligence, pays a crossed cheque to a financial institution, the drawee institution is taken to have paid the cheque in due course."

The protection offered by sec 92 is limited to regular and unaltered crossings on cheques. It provides no protection for payment of a cheque which has been materially altered (possibly covered by sec 93: ¶16-500) or irregularly indorsed (sec 94(2): ¶16-510).

- *Application:* to cheques (ie order and bearer) which are crossed.

9. *R v Jell, ex parte Attorney-General* [1991] 1 Qd R 48.

1909 (Cth). It was amended in the 1998 amendments (¶16-190).

10. Section 92 of the *Cheques Act* is based on sec 86 of the *Bills of Exchange Act*

- *Protection*: where drawee institution pays a crossed cheque to a financial institution.
- *Test*: “in good faith and without negligence”.
- *Protection given*: drawee institution entitled to debit the customer’s account with the amount of the crossed cheque; value of drawer’s crossing confirmed.

Certain conduct which would fall outside the protection offered by sec 93 (¶16-500) and sec 94 (¶16-510) would also fall outside sec 92 such as:

- failure to examine order cheques for indorsements;
- payment of a cheque without reference to an inadequate or irregular indorsement (though this was held not to have occurred in *Derham’s case*¹¹);
- any negligence to do with the paying of this cheque (rather than to do with collateral performance within the financial institution’s system of business).¹²

— *Case example* —

The plaintiff executors of an estate sued the defendant bank for the sum of \$5,000 which was lost in the following circumstances. The plaintiffs decided to invest \$5,000 in a government loan through a firm of brokers. Having drawn the cheque payable to the brokers they gave it to their solicitor to forward. Instead of forwarding it to the brokers he altered it by writing in the blank space after the brokers’ name and the printed words “or order” the words “per C & P” (his firm). He then indorsed the cheque in the firm’s name and paid it to an account of a finance company of which he was director. It was held that the bank could not rely upon the sec 94 equivalent, because the cheque had been “materially altered” within the meaning of the sec 3(8) equivalent and therefore the payment was not protected by the Act. For the same reason it was held that the bank could not rely upon the sec 92 equivalent of the Act.

— *Slingsby v District Bank Ltd*¹³ —

¶16-500 Section 93: protection on payment of crossed cheques. A drawee institution is required to comply with any crossing (as defined in sec 53: ¶16-400) placed on a cheque by its customer, the drawer, and therefore to pay the cheque only to another financial institution (¶16-390—¶16-450). Section 93(1) confirms that failure to pay a crossed cheque to another financial institution renders the drawee institution liable to the true owner of the cheque for any loss that the true owner (¶16-540) suffers as a result of the cheque having been paid otherwise than to a financial institution. However, whereas sec 92 protects against a “regular” crossing, sec 93 protects against what may be loosely described as an “irregular” crossing.

11. *AMP Society v Derham* (1979) 39 FLR 165.

12. *Ibid*, at p 177.

13. [1932] 1 KB 544; [1931] All ER Rep 143.

Section 93(2)¹⁴ protects the drawee institution against potential legal liability to the true owner of the cheque for failure to pay to a financial institution a cheque which does not appear to be or to have been crossed.¹⁵

Section 92 is also to be read subject to sec 32(1) and (2) (¶16-370) which confirm that an unauthorised or forged signature on a cheque is “wholly inoperative”, unless there is estoppel or ratification of the signature (see also ¶16-480).

“Payment of crossed cheque otherwise than in accordance with crossing

93(1) Subject to subsection (2), where the drawee institution pays a crossed cheque otherwise than to a financial institution, the drawee institution is liable to the true owner of the cheque for any loss the true owner suffers as a result of the cheque having been paid otherwise than to a financial institution.

93(2) Subject to subsection 32(1), where:

- (a) a crossed cheque is presented for payment to the drawee institution;
- (b) the cheque, at the time of presentment, does not appear, on its face, to be, or at any time to have been, a crossed cheque; and
- (c) the drawee institution, in good faith and without negligence, pays the cheque otherwise than to a financial institution;

the drawee institution:

- (d) does not, in paying the cheque, incur any liability by reason only of its failure to pay the cheque to a financial institution; and
- (e) shall be deemed to have paid the cheque in due course.”
- *Application:* to order and bearer cheques which are crossed.
- *Protection against:* drawee institution failing to pay to another financial institution a crossed cheque which does not appear to be crossed.
- *Test:* “in good faith and without negligence”.
- *Protection given:* drawee institution entitled to debit customer’s account with the amount paid and be protected from any legal action by the true owner.

— *Case example* —

A stolen cheque was presented by the thief to the defendant bank which paid it. The payee (the owner of the cheque) was unsuccessful in his action against the bank in negligence. P’s argument was that the cheque was crossed, and was not paid to a banker under the forerunners of sec 53, 93. At issue as a result was the face of the cheque. It was written in a fine pen, and drawn “pay Mr Mather or Bearer”. The word “Bearer” was scratched out, and from the end of the word “Mather” to the word “or” was a space of some three centimetres. This space was filled with two roughly parallel lines, in the same fine hand. This was held to be insufficient

14. Section 93 is based on sec 85 of the *Bills of Exchange Act 1909* (Cth). It was amended in the 1998 amendments (¶16-190).

15. Obliterating a crossing on a cheque is a criminal offence under, eg, *Criminal Code 1995* (Qld) sec 190; *Criminal Law Consolidation Act 1935* (SA) sec 222.

to constitute a crossing, and hence the actions of the bank's ledger keeper and teller, who had passed it as an open cheque, were considered to be not negligent.

*Mather v Bank of New Zealand*¹⁶

¶16-510 Section 94: protection on payment of unauthorised, absent or irregular indorsements. The drawee institution has no means of determining the validity of an indorsement added to a cheque by a person who may or may not be its customer and it could run the risk of action by its customer, the drawer, in negligence, conversion or breach of contract in a situation essentially beyond its control. Hence sec 94 of the *Cheques Act* provides legal protection to the drawee institution, acting in good faith and without negligence, from the potential legal liability of not complying with an indorsement in two situations:

- where an indorsement is “written or placed on the cheque without the authority of the person whose indorsement it purports to be” (sec 94(1)), and
- where the cheque is not indorsed or is irregularly indorsed (sec 94(2)).

Each subsection is to be read subject to sec 32(1) (¶16-370), which confirms that an unauthorised or forged signature of the drawer is “wholly inoperative” (subject to estoppel or ratification: ¶16-370; ¶16-380).

The two subsections of sec 94 are based on sec 65 and 88B respectively of the *Bills of Exchange Act* and apply in two related but different situations:

Section 94(1): unauthorised indorsement. Section 94(1) provides that where the drawee institution pays a cheque drawn upon it in good faith and without negligence, and the cheque contains an unauthorised indorsement, the institution does not incur any liability because of the indorsement and is deemed to have paid the cheque in due course. However, an unauthorised or forged indorsement may be effective if ratified by the person whose signature it purports to be (sec 32(2)(b): ¶16-370) or if the person against whom it is asserted is estopped from denying the genuineness of the signature (sec 32(2)(a): ¶16-370; ¶16-380).

- *Application:*

- (a) all cheques payable to order;
- (b) cheques containing forged signatures.¹⁷

16. (1918) 18 SR (NSW) 49.

17. The Manning Committee, which drafted sec 88B, the forerunner of sec 94(2), clearly stated that the section was intended to protect the paying bank paying on a forged indorsement: Manning Committee Report, *op cit*, para 144. This view was also expressed tentatively in *Derham's case*

(1979) 39 FLR 165 at p 179; (1979) 25 ACTR 3 at p 17, and is confirmed in the *Cheques Act* sec 3(6) and in the *Explanatory Memorandum — Cheques Bill 1985, op cit*, para 42, 43, 432. Sec 94 was amended in the 1998 amendments (¶16-190) by replacing “bank” with “drawee institution”.

- *Protection against:* unauthorised and forged indorsements (or failure to pay attention to authority or lack of authority for an indorsement).
- *Test:* cheque paid “in good faith and without negligence”.
- *Protection given:* drawee institution entitled to debit customer’s account with the amount paid and be protected from action in conversion by the true owner.

Section 94(2): absence of or irregularity in indorsement. Where the drawee institution pays an order cheque to another financial institution collecting for the payee or indorsee, the drawee institution (but not the collecting institution: ¶16-540) can ignore the absence of or irregularity in an indorsement. Section 94(2) provides that where the drawee institution pays a cheque drawn upon it to another financial institution in good faith and without negligence, and the cheque is not indorsed or is irregularly indorsed, the drawee institution is protected from legal liability and the cheque is deemed to have been paid in due course.

- *Application:* cheques of the following kinds paid to another financial institution:
 - (a) those which are not indorsed;
 - (b) those which are irregularly indorsed;
 - (c) and whether crossed or not or to order or bearer (this is the full range of cheques).
- *Protection:* where drawee institution pays the cheque to another financial institution.
- *Test:* “in good faith and in the ordinary course of business”.
- *Protection against:* liability incurred by reason of absence of indorsement, or irregularity in indorsement.

It seems that drawee institutions acting in the ordinary course of business should be protected.

These views were confirmed in the first reported Australian case on the forerunner of sec 94(2), which was decided by the Supreme Court of the ACT in 1979:

— *Case example* —

AMP Insurance drew a cheque for the surrender value of a life policy payable to the insured Mr and Mrs B or order as payees. The cheque was crossed generally. As requested by the insured, the cheque was posted direct to the insured’s insurance agent, C, who subsequently stole the cheque by forging the signature of one payee only (Mr B) on the *face* of the cheque (an indorsement by both parties was technically required by the forerunner of sec 43 on a cheque made payable to two or more payees: cf ¶16-290). Moreover, by later forging an indorsement to himself on the back of the cheque, C split the indorsement. The cheque was credited to C’s account, having been paid by B’s bank.

As true owners of the cheque, Mr and Mrs B sued their bank, the paying bank, for conversion and for money had and received (§16-510). The forerunners of sec 92 and 94 were successfully relied on by the bank. The loss of the amount therefore fell on Mr and Mrs B, because of the misappropriation by C, and the only remedy would have been to recover from C.

————— *Australian Mutual Provident Society v Derham*¹⁸ —

¶16-520 Payment of cheque “in good faith and without negligence”. Each of the sections providing protection against legal liability to a drawee institution wrongly paying a cheque requires that the payment by the institution be “in good faith and without negligence”: sec 92 (¶16-490); sec 93 (¶16-500); sec 94(1) and (2) (¶16-510).

“Good faith” is explained in sec 3(2) of the *Cheques Act* as “a reference to the act or thing being done honestly, whether or not the act or thing is done negligently” (¶16-090).

The concept and meaning of negligence in the law of tort is clear (Chapter 4), and has unrelenting and ever-expanding application in the law and practice of financial institutions.

Apparent regularity and correctness may be enough to prevent the drawee institution from being alerted to any defect, but if the drawee institution knew or ought to have known that a signature was forged or unauthorised, it could not be claimed to be acting “in good faith and without negligence” and could lose the protection of sec 94 (¶16-510). Nor would such a payment qualify as falling within the ordinary course of business, a test tied to the standard of trade usage or customary course of conduct of financial institutions.

The following transactions would not qualify as “in good faith and without negligence” for the purposes of protection of the drawee institution under any of the protections offered by sec 92-94:

- failure to require a correct, regular or complete indorsement;
- payment over the counter of a large amount of cash where there are suspicious circumstances;
- failure to inquire in other circumstances where suspicion is aroused, eg “presentation by a tramp, or a postman or an office boy”;¹⁹
- getting no verification of an indorsement appearing in non-English characters, eg in Chinese;
- failure to comply with the customer’s instructions on the face of the cheque, eg failure to honour a crossing;

18. (1979) 39 FLR 165; noted (1981) 55 ALJ 41. Payment to an insurance agent does not discharge the insurer’s liability to the insured under the *Insurance*

(*Agents and Brokers*) Act 1984 (Cth) sec 14(3): ¶17-570.

19. *Auchteroni & Co v Midland Bank Ltd* [1928] 2 KB 294, per Wright J at p 304.

- where the drawee institution has reason to believe that an authorised company signatory is misapplying company funds;
- where there has been a material alteration of the cheque.

However, the burden of proof lies on the customer to prove that these or any other facts fall outside the ordinary course of business and are negligent. Hence:

- An irregular and/or inadequate indorsement was not so proved by the customer in *Derham's case*²⁰ (¶16-510). The judge, however, confirmed that the drawee institution (the paying bank) is not concerned with the character of indorsements — that is the responsibility of the collecting institution (¶16-540).
- Failure on the part of an ACT bank to collect NSW stamp duty on a cheque which was drawn in NSW on an ACT bank, payment of which was collected in the ACT, was in *Derham's case* also held not to fall outside “the ordinary course of business”.

PROTECTION TO THE COLLECTING INSTITUTION

The collecting institution and legal liability ¶16-540

The defence of contributory negligence ¶16-550

¶16-540 The collecting institution and legal liability. In contrast to the protection available to the drawee institution, which is covered by four different sections of the *Cheques Act* applying in various circumstances (¶16-470), the law protecting the collecting institution from possible legal liability in conversion (tort), negligence (tort), breach of contract, and/or restitution (¶16-510) is stated in the two subsections of sec 95:²¹

Section 95(1): customer has no title or defective title. Section 95(1) protects the collecting institution in the following words:

“Where:

- (a) a financial institution (the collecting institution), in good faith and without negligence:
 - (i) receives payment of a cheque for a customer; or
 - (ii) receives payment of a cheque and, before or after receiving payment, credits a customer's account with the sum ordered to be paid by the cheque; and
- (b) the customer has no title, or has a defective title, to the cheque,

20. *AMP Society v Derham* (1979) 39 FLR 165. Indeed, the indorsement appeared most irregular, though irregularity was not proved.

21. Based on *Bills of Exchange Act* sec 88D(1)-(3). Sec 95 was amended in the 1998 amendments (¶16-190).

the collecting institution does not incur any liability to the true owner by reason only of having received payment of the cheque.”

- *Application*: all cheques, especially third party cheques: ¶16-260.
- *Protection*: where payment is collected by the collecting institution.
- *Test*: “in good faith and without negligence”.
- *Protection against*: where the customer has no title or has a defective title, the collecting institution does not incur liability in conversion or negligence to the true owner. The “true owner” is the person entitled to the property in and the possession of the cheque: this is the drawer when the cheque is drawn and it is the payee after the cheque has been delivered to the payee.²² The true owner can sue for conversion of the cheque. If the drawer is defrauded into issuing a valid cheque to a fraudster, it is no longer the “true owner” and cannot sue the collecting institution.²³

However, the facts may not justify any defence under sec 95. As with the drawee institution, the collecting institution must have acted “in good faith and without negligence” (see ¶16-520).

— Case examples —

The plaintiff butcher (Cary) drew a cheque for £349 payable to Ray Taylor Pty Ltd, a wholesale butcher, and mailed it to him. It was never received by the payee as it came into the hands of an unauthorised person who used it to open an account in the name of Ray Taylor with the then Rural Bank with the express purpose of collecting payment on it. The bank was later sued by the true owner (Cary) for conversion and a number of facts came to light which indicated negligence on the part of the bank in identifying the new customer before opening the account. The bank’s defence under the forerunner of sec 95 failed. *Clegg J* was of the opinion that the bank was negligent in the following respects: “(1) The proposed customer should have been referred to the manager of the bank before the account was opened. (2) The proposed customer should have been asked why he chose this particular bank at Auburn in the light of the fact that he himself lived at Caringbah and, allegedly, worked at Granville. (3) The bank’s officer was negligent in not getting the address of the drawer of the cheque and inquiring from him as to the nature of the transaction to which the cheque related. ... (4) The bank officer was guilty of negligence in not inquiring from the proposed customer’s alleged employers as to whether he was employed by that particular company. ... (5) He was negligent in not observing the name on the licence and checking the age shown thereon with the age of the proposed customer. (6) He was guilty of negligence

22. eg *Hunter BNZ Finance Ltd v Australia and New Zealand Banking Group Ltd* [1990] VR 41 at pp 46-47; upheld [1991] 2 VR 407. The same expression “true owner” also appears in sec 93: ¶16-500.

23. eg *Citibank NA v Brown Shipley & Co Ltd* [1991] 2 All ER 690; contrast *Hunter BNZ Finance Ltd v CG Maloney Pty Ltd* (1988) 18 NSWLR 420.

in accepting as evidence of identity the proposed customer's alleged knowledge of the bank's customer ..."

_____ *Cary v Rural Bank of New South Wales*²⁴ —

After collecting payment of third party bearer cheques for a customer with a name different from that of the payee, the NAB was ordered to pay almost \$600,000 as damages for conversion of cheques, made up of the face value of the cheques (about \$285,000) and about \$315,000 as damages for the customer's net loss of past, present and future business income. The bank's conduct failed to come within the protection offered by sec 95.

_____ *Nemur Varity Pty Ltd v National Australia Bank Ltd*²⁵ —

Section 95(2): order cheque with absent or irregular indorsement.

Section 95(2) of the *Cheques Act* provides that for the purposes of protection from liability under sec 95(1), a collecting institution will not be treated as negligent by reason of absence of, or irregularity in, an indorsement of a cheque by its customer if the name specified in the cheque as the name of the payee:

- (i) is the same as the name of the customer;
 - (ii) is the same as a business name or trade name of the customer; or
 - (iii) is so similar to the name of the customer, or a business name or trade name of the customer, that it is reasonable in all the circumstances for the collecting institution to have assumed that the customer was the person intended by the drawer to be the payee.
- *Application*: order cheques which have not been transferred by negotiation (¶16-280); especially third party cheques: ¶16-260.
 - *Protection*: where payment is collected by the collecting institution.
 - *Test*: as for sec 95(1) above.
 - *Protection against*: erroneous assumption by the collecting institution, because of the similarity, etc in name, that the customer was the person intended by the drawer to be the payee.

24. (1967) 2 DCR (NSW) 49. Compare *Marfani and Co Ltd v Midland Bank Ltd* [1967] 3 All ER 967; [1968] 2 All ER 573 (bank held not negligent); *Australia and New Zealand Banking Group Ltd v Amev Finance Ltd* (1989) Aust Torts Reports ¶80-228 (crossed cheque marked "Not Negotiable Account Payee Only" bearing forged indorsement with indecipherable signature collected for third party; bank liable for conversion to drawer); *Australian Guarantee Corporation Ltd v Commissioners of the State Bank of Victoria* [1989] VR 617; (1989) Aust Torts Reports ¶80-229 (bank manager ignored instructions ("not

negotiable credit bank a/c payee") on bearer cheques and failed to make inquiries: bank liable for conversion); see further Edwards, R, *Third party cheques: what is an appropriate response by a collecting bank upon presentation?* (1995) 3 CCL 121; Robson, K and Farr, C, *Third party cheques: are they still negotiable instruments?* (1998) 72 ALJ 790.

25. [1999] VSC 342; noted eg Weerasooria, W, *Bank's liability for conversion and damages for loss of business income* (2000) 15 BLB 137. The bank was also held liable as paying bank.

Section 95 does not, however, cover every situation which may face a collecting institution. It is designed to free the collecting institution from the duty to check that the payee has signed a cheque on the back when it is paid in. It does not free the collecting institution from checking the absence of or irregularity in indorsements unless the name of the payee is the same as that of the customer, or so similar that it is reasonable in the circumstances to assume that the customer was the intended payee (sec 95(2)). Hence if the payees in *Derham's case* (¶16-510) had chosen to sue the collecting bank rather than the paying bank, this bank might have lacked the sec 95 statutory defence; the Manning Committee did note (at para 138) that "the collecting bank should continue to be responsible for ensuring that cheques are regularly indorsed if it is not collecting for the payee".

¶16-550 The defence of contributory negligence. Australian case law does not allow a financial institution, when sued for negligence, to claim the defence of contributory negligence on the part of the owner of the cheque to reduce or apportion the compensation claimed (¶4-160).²⁶

In contrast, English cases do allow the defence of contributory negligence.

— *Case example* —

The stockbroker customer's practice of drawing cheques to clients in an abbreviated form (a cheque payable to Brown Mills & Co payable to Brown) led to an employee paying some of the cheques into a dummy account. When the bank was sued by the customer for conversion of the cheques, the bank was able to plead contributory negligence on the part of the stockbroker customer and the damages awarded against the bank were reduced by 10%.

_____ *Lumsden & Co v London Trustee Savings Bank*²⁷ _____

OTHER BANKING AND FINANCE FACILITIES _____

Bills of exchange	¶16-560
Trade bills	¶16-570
Commercial or accommodation bills	¶16-580
Negotiation of bill of exchange	¶16-590
Liability of the parties to a bill	¶16-595
Discharge of bill of exchange	¶16-596
Cheques a financial institution draws on	
itself (bank cheques)	¶16-600
Promissory notes	¶16-615
Travellers cheques	¶16-620

26. eg *Wilton v Commonwealth Trading Bank of Australia* [1973] 2 NSWLR 644; *Day v Bank of New South Wales* (1978) 33 FLR 376; *Grantham Homes Pty Ltd v ANZ Banking Group Ltd* (1979)

26 ACTR 1; *Australian Guarantee Corporation Ltd v Commissioners of the State Bank of Victoria* [1989] VR 617; (1989) Aust Torts Reports ¶80-229.

27. [1971] 1 Lloyd's Rep 114.

¶16-560 Bills of exchange. Negotiable instruments include cheques, promissory notes (¶16-615) and bills of exchange. (Travellers cheques (¶16-620) and bills of lading are not negotiable instruments because neither is transferable by negotiation so as to give good title to the transferee.)

Many of the principles governing cheques which have been discussed earlier in this chapter are equally relevant to bills of exchange and are discussed in the following paragraphs.

There are differences between cheques and bills of exchange, and these are noted at ¶16-220.

Bills of exchange are regulated mainly by the *Bills of Exchange Act 1909* (Cth). This used to regulate cheques as well, but it was amended in 1986 by removing regulation of cheques to the *Cheques Act 1986* (Cth) (¶16-190ff).

Uses of bills of exchange. Bills of exchange were developed by merchants from at least the twelfth century as an alternative to the risk and inconvenience of carrying bags of gold and silver coins. Merchant B can direct its debtor, A (the drawee) to pay by bill B's creditor C (the payee) direct.

If A agrees that the amount is owing and is willing to pay the amount on the due date of the bill, A accepts the bill by writing across its face "accepted", and signs it. (See liability of acceptor, *Bills of Exchange Act 1909* (Cth) sec 59; acceptance, sec 22-24; definition of "acceptance", sec 4.) The bill is then sent by A to C who may keep the bill until its due date. C then presents it for payment to A, the bill is paid and liability on it is discharged.

If A is not prepared to accept B's bill, A obviously never becomes the acceptor and never attracts the liabilities of acceptor. But the bill would be dishonoured as a result. (Dishonour by non-acceptance, sec 47-48.)

A bill is also dishonoured where A refuses to pay the bill drawn by B. C, who will not be paid by A as a result, will still be able to get payment from B, the original debtor. (Dishonour by non-payment, sec 52.) When this bill is dishonoured, C should *note* and *protest* the bill for non-acceptance or non-payment for the purpose of evidence.

Bills of exchange are commonly bought and sold on the money market (usually before they are due and payable) under what is called discounting (discussed further at ¶16-570 and ¶16-580). When a bill is discounted, the purchase price is not normally the face value of the bill. A discounting arrangement does not usually involve the creation of a debt and does not come within the Consumer Credit Code. The Code states that "credit arising out of a bill facility, that is, a facility under which the credit provider provides credit by accepting, drawing, discounting or endorsing a bill of a exchange" is not credit to which the Code applies.²⁸

28. Consumer Credit Code sec 7(5) (¶14-150), but the subsection goes on to say, "However, the regulations may

provide for the application of the Code to the provision of all or any credit arising out of such a facility."

Bills of exchange have been more and more widely used as a source of business finance since 1965, when the Reserve Bank encouraged an active bills market by suggesting to the trading banks that they make use of their existing powers to accept and discount bills. In addition, the Reserve Bank approved authorised dealers entering the short term money market dealing in bills which had been accepted or indorsed by a trading bank.

With this rapid growth in the use of trade and commercial bills, there has been equivalent growth in the associated institutions, the money market corporations (the merchant banks or the accepting houses).

Creditor C can use the bill to pay its own creditors. If the bill is payable at some future time, the creditor can discount the bill to get funds immediately. Bills can therefore achieve two functions — they give credit to the debtor until the bill matures, and, by discounting the bill, they give funds to the creditor.

Bills of exchange in the business community are of two main kinds, known as trade bills and commercial, finance or accommodation bills. The classes are not watertight and no real significance attaches to any supposed differences.

Advantages of bills of exchange. Bills of exchange have the following advantages:

- (1) Bills are a ready substitute for cash, and like cheques they avoid the risk of theft, loss or forgery, as set out in ¶16-210.
- (2) Bills may be drawn payable to a third person. If A owes B \$1m, and B owes C \$1m, B can draw a bill on A to pay C direct.
- (3) Bills can be easily transferred by negotiation — C can transfer a bill to one of its creditors by negotiation, such as person D. No notice of transfer is required in order to transfer liability on the bill to C's creditor D as a holder (¶16-360). If D is a holder in due course (D), D holds the bill free from earlier defects in title (¶16-240, ¶16-360, ¶16-590).
- (4) Bills can be enforced by the holder against earlier persons and they are not subject to the rules of privity (¶16-270).
- (5) Bills can be discounted. This means the holder can cash the bill before it is due, by transferring it at a discount to another holder (a discounter) who pays less than the face value of the bill.
- (6) Bills provide flexibility as a means of short term financing as the needs of borrowers vary.
- (7) Bills enable borrowers to defer the raising of equity or debt capital.
- (8) Bills are an investment, with no transfer fees or documentation, because title to the bill is transferred on delivery.
- (9) Regulation of bills under the *Bills of Exchange Act* is well known, and it builds on centuries of practice.

Definition of bill of exchange. A bill of exchange may be thought of as a "cheque" drawn on a person — as defined in sec 8(1) of the *Bills of Exchange Act*:

“A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.”

This definition can be explained as follows:

“unconditional order”. The order must be unconditional and have no preconditions to payment. It must be a command, not a request. An expression such as “we hereby authorise” has been held not to be a command and such an order would fail as a bill of exchange.

“in writing”. A bill of exchange must be in writing (¶15-030). Section 4 states that “writing” includes “printed”, but there is no law on what the writing must be on.

“addressed by one person to another”. A bill is drawn by *drawer* B and is drawn on *drawee* A who becomes the *acceptor*. The drawee must be clearly named (sec 11(1)), and there may be more than one drawee (sec 11(2)). The bill is payable to the *payee* C.

“signed by the person giving it”. The requirement of signature (sec 28) includes a facsimile signature. A forged or unauthorised signature is not valid (sec 29).

“pay on demand”. Section 15 provides that a bill is payable on demand when it “is expressed to be payable on demand, or at sight, or on presentation ... or ... in which no time for payment is expressed”.

“at a fixed or determinable future time”. Section 16 provides that a bill is payable at a “determinable future time” when it is payable at a fixed period after date or sight, or at a fixed period after the occurrence of a specified event, not a contingency.

“a sum certain in money”. The amount payable must be able to be calculated arithmetically, so a bill payable with interest, or in a foreign currency, comes within the definition. Section 14(1) provides that the sum payable is a sum certain even if required to be paid:

- “(a) [with] interest or bank charges, or
- (b) [by] stated instalments, or
- (c) [by] stated instalments, with a provision that upon default in payment of any instalment the whole shall become due, or
- (d) according to an indicated rate of exchange, or according to a rate of exchange to be ascertained as directed by the bill.”

“to, or to the order of a specified person, or to bearer”. Like cheques, bills are payable to order (pay “C or order”) or to bearer (“pay C or bearer”) (¶16-250ff).

¶16-570 Trade bills. Bills of exchange are either trade bills or commercial (or accommodation) bills (¶16-580).

¶16-570

Trade bills are used to finance imports and exports. They provide the means by which a seller of goods can be paid before the buyer is in a position to pay. A trade bill, therefore, provides formal documentation of a trade debt and as a means of finance has a significant role to play. The key to any bill is that it can be discounted in the bills market, meaning that the seller can be paid, regardless of whether the buyer is in a position to pay.

A transaction involving trade bills may operate as follows:²⁹

— *Example* —

At the time of delivering the goods to her customer, a manufacturer draws a 90-day bill of exchange on the customer for \$100 for the amount of the purchase price of \$100 payable to herself or order. When the customer accepts the bill, the customer gives himself 90 days before he need pay the bill. The manufacturer can sell (or “discount”) the bill on the short term money market; the customer, of course, must pay the bill upon maturity but this can be done from the proceeds of the sale of the goods delivered from the manufacturer.

Discounting, however, is the other feature of the bills market. It depends on the fact that a bill of exchange is a negotiable instrument and is freely assignable. Because a bill can be negotiated by indorsement and delivery, it can be readily bought and sold.

The manufacturer in the above example, holding a 90-day bill for \$100 drawn on a customer, can keep the bill and present it to the customer for payment at the end of the 90 days; or if in need of liquid funds before that time, the manufacturer can offer the bill on the bill market.

If a purchaser pays \$97 (at a discount) for the bill and keeps it until maturity the purchaser will earn \$3 interest on the \$97 over the 90 days' duration of the bill (ie approximately 12.54% per annum). Alternatively, this new holder may in turn consider selling the bill.

- If interest rates are rising, the holder would be unlikely to sell the bill because a prospective purchaser in a rising market would only buy the bill if a greater discount were available.
- If interest rates are falling, the holder of the bill may be able to re-discount it a few days later for \$98. This means the holder will have made \$1 by only holding the bill for a week.

In other words, trade bills, as the earliest class of bill, were and are still based on the need to create an instrument or document to allow for what was in effect payment on credit. These bills are still used extensively for the financing of exports and imports and there continues to be a demand for local financing of goods between Australian companies by way of trade bills.

29. Examples based on those of Walker, G de Q, *The Australian Revival of the Bill*

of Exchange, (1978) 52 ALJ 244 at pp 245, 247-248.

¶16-580 Commercial or accommodation bills. Commercial bills are marketable short term debt instruments used to obtain short term funds. They are of two types:

- *Bank bills.* The trading bank is the acceptor and discounters. In addition, trading banks can indorse, “back” or “put their name” to a bill accepted by another party, and by so doing give the bill that extra security — in effect guaranteeing that the bill will be repaid. In backing a bill, the trading bank may face liability as an indorser under sec 61 of the *Bills of Exchange Act* (the equivalent is sec 75 of the *Cheques Act 1986* (Cth), discussed at ¶16-350).
- *Finance bills.* Finance or non-bank bills do not have bank acceptance, but are often backed by bill acceptance companies, finance companies and authorised dealers. Because these bills do not have trading bank backing, finance bills may be more difficult to discount in the bill market.

Commercial bills are created in one of two ways.³⁰

— *Examples* —

A company seeking funds draws up a bill for the amount it needs and finds an acceptor. Once the bill has been accepted, the drawer has to find a discounters for the bill, who is the person who lends in exchange for the bill. If the discount rate is 2% per quarter, a 90-day bill with a face value of \$100,000 will raise \$98,000 and this is the amount the drawer will receive from the discounters in exchange for the bill. At maturity date, the holder of the bill (the original discounters or any other party) will approach for repayment the acceptor, who is repaid by the drawer. But it is the acceptor who is liable to pay, in the above example, the \$100,000 originally advanced.

Alternatively, a bill can be created by having it accepted and discounted by the party lending the funds. The acceptor keeps the bill as evidence of the debt. At maturity date, the discounters approaches the acceptor for repayment of the face value of the bill. Because the acceptor and the discounters are the same entity, there is no problem with repayment to the acceptor as the acceptor is the original lender.

What has happened then — and it illustrates the difference between a commercial bill and a trade bill — is that the acceptor (the principal debtor under the terms of the bill) has accepted it not necessarily for valuable consideration but to enable another person (who may or may not be a party to the bill) to raise money upon it. In other words, the commercial bill is a ready means of raising short term finance for the trader and for the lender or investor as it enables the extending of credit to a customer without actually committing any liquid funds.

Accommodation bill. The Act defines commercial bills or finance bills as accommodation bills (sec 33). If the bill used in the above example were an

30. See, eg, Peirson, G, Brown, R, Easton, S and Howard, P, *Business Finance*, McGraw-Hill, 7th ed, 1998, pp 342ff.

accommodation bill rather than a trade bill, its method of creation would have been slightly different. Rather than having been drawn privately, it might have been prepared by a specialist bill “manufacturing” company. These companies prepare bills, discount them and advise generally in consideration of a fee which is paid by the accommodated party.

The bill could be drawn by a development company which needed short term finance for progress payments. This bill could be drawn by the development company on its parent company made payable to the developer or order. The parent company, on accepting the bill, could either return it to the developer or to the bill company which would arrange the discounting of the bill on the market and to forward the proceeds to the developer.

Financing with bills of exchange may be under a “*bill line of credit*” or a “*bill facility*”, where the financier commits itself to accepting or indorsing bills, or providing an overdraft or finance with a bill option, for an agreed period. Some financiers provide a “*bill acceptance and discount facility*” where they both accept the bill and agree to sell it for the client.

¶16-590 Negotiation of bill of exchange. As discussed at ¶16-240, negotiation means transfer of ownership by delivery (bearer bill), or by indorsement and delivery (order bill) so that the transferee may get better title than the transferor (which cannot happen with a “not negotiable” cheque: ¶16-420). Section 36 explains that “A bill is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the bill.”

Like a bearer cheque, a bearer bill is negotiated by delivery — by just handing it over: ¶16-270.

Like an order cheque, an order bill is negotiated by delivery and indorsement. The rules on indorsement are set out at ¶16-290.

¶16-595 Liability of the parties to a bill. The liability of the parties to a bill of exchange parallels the liabilities of the parties to a cheque, as set out at ¶16-340—¶16-350.

Drawer. The drawer is the person who creates the bill. Drawer B is normally a creditor of the drawee A. Under sec 60, the drawer promises to pay the bill on presentment. This parallels the liability of the drawer of a cheque, as set out in ¶16-340. The drawer engages to:³¹

- “(a) pay the face value of the bill to the acceptor before the bill matures;
- (b) pay the face value of the bill upon its maturity (either directly to the holder or the acceptor); or
- (c) indemnify the acceptor against the consequences of non-payment.

31. *Coles Myer Finance Ltd v Commissioner of Taxation* (1993) 67 ALJR 463 at p 467.

The drawer's liability under (c) would not legally be enforceable until the acceptor made payment to the holder.

However, the proposition that, upon acceptance of the bill, the drawer undertakes a continuing liability to pay the amount of the bill to the acceptor finds very strong support in the authorities.”

Drawee. Drawee A is the person to whom the bill is addressed by drawer B. By agreeing to pay the bill (by accepting it), the drawee becomes the *acceptor* (sec 59). Section 59 prevents the acceptor from denying the genuineness of the drawer's signature;³²

“Upon acceptance, the primary responsibility for paying out the face value of the bill upon its presentment lies with the acceptor. The drawer then becomes subject to a secondary liability to pay out the bill in the capacity of a surety. But the liability arises only if the acceptor fails to pay out and the requisite procedures on dishonour are taken (sec 60).

An acceptor who signs a bill without receiving value therefor and for the purpose of lending his or her name to some other person is an accommodation party (sec 33(1)). ‘Value’ in this context refers to the discount or part of it and does not include bank fees for services in providing accommodation. An acceptor who is an accommodation party is liable on the bill to a holder for value (sec 33(2)).”

Payee. Payee C is the person whom drawee A has to pay on the instruction of drawer B.

Indorser. As with cheques (¶16-350), the indorser of a bill of exchange (person C) incurs liability to the indorsee (D) to honour the indorsement under sec 60(2).

Accommodation party. The drawer, indorser or acceptor can raise their credit standing by having an accommodation party such as a financial institution lend their name to the bill. The accommodation party is liable on the bill to the holder for value (sec 33).

Referee in case of need. The drawer and indorser can raise their credit standing by adding the name of a person to whom the holder can resort in case of need in the event of dishonour by non-acceptance or non-payment (sec 20).

Backer of bill. For the same reasons as signing a bill as an accommodation party or as a referee in case of need, a person may back a bill as a backer or “stranger”. By doing so, the backer incurs the liability of an indorser to a holder in due course under sec 61 (compare ¶16-350).

Holder. As with cheques, and as defined in sec 4, the holder is the bearer (the person in possession) of a bearer bill, or the payee or indorsee of an order bill (sec 43): ¶16-360. The title of the holder may be subject to the rights of others to the bill.

32. Ibid, p 466.

Holder for value. As with a cheque, a bill can be enforced by the holder under sec 43 if the holder has given value or consideration for it: ¶16-360. The holder for value can hold acceptor A (the principal debtor according to the instrument) primarily liable on the bill.

Holder in due course. The holder in due course is not payee C (to whom the bill is *issued*), but is the next person, D, to whom C has *negotiated* the bill. The holder in due course is the holder who has taken in good faith, for value, and with no notice of any defect in title of the person who negotiated it, a bill which is:

- complete and regular on its face, and
- not overdue,

with no notice of any previous dishonour (sec 34).

If a holder in due course, the holder “holds the bill free from any defect of title of prior parties”: sec 43. This parallels the equivalent provisions of cheques discussed at ¶16-360.

¶16-596 Discharge of bill of exchange. Sections 64-69 state that a bill of exchange is discharged by:

- payment in due course (sec 64); compare the payment of a cheque discussed at ¶16-320;
- non-payment; if the bill is dishonoured, the holder can recover from the drawer and indorsers (sec 52);
- the acceptor becoming the holder (sec 66);
- waiver or renunciation (sec 67);
- cancellation (sec 68);
- material or significant alteration (sec 69).

Bills of exchange law has always upheld the sanctity of the dishonoured bill of exchange: that “any claim for unliquidated damages under a contract for sale is no defence to a claim under a bill of exchange accepted by the purchaser; nor is it available as a set off or counter-claim”.³³ This view may be changing with the arrival of *Trade Practices Act 1974* (Cth) sec 52, which may allow a counter-claim for “misleading or deceptive conduct”.³⁴

¶16-600 Cheques a financial institution draws on itself (bank cheques). Cheques traditionally called “bank cheques” are frequently used for payment for large purchases such as a car, real estate and the like, on the basis that they are more or less the equivalent of cash.

33. *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 1 WLR 713 at p 732.

34. *John Shearer Ltd v Gehl Co* (1996) ATPR ¶41-499, noted (1996) 70 ALJ 528; ¶7-280.

The 1998 amendments extended the law of “bank cheques” to cheques that a building society, credit union or Special Services Provider draws on itself so that they will have the same function as bank cheques (“Cheques a financial institution draws on itself”: sec 5).

Section 5(1) now recognises that all of the *Cheques Act* applies to cheques a financial institution draws on itself,³⁵ and sec 5(4) confirms that such a cheque is a cheque with the same status as “an instrument that would be a cheque if the drawer and drawee were not the same person.”

A bank cheque is not cash and can be dishonoured, but the Australian Bankers Association has published the following reassurances concerning the reliability of bank cheques.³⁶

- (1) A forged or counterfeit instrument is not a bank cheque and will not be paid. A forgery is “wholly inoperative” under sec 32 of the *Cheques Act* (¶16-370).
- (2) A materially altered bank cheque may be dishonoured.
- (3) A bank cheque reported lost or stolen will not be honoured.
- (4) A bank will observe a court order restraining payment of a bank cheque.
- (5) A bank can dishonour a bank cheque where there is failure of consideration on the part of the holder.³⁷ In contrast, a bank cannot stop payment of a bank cheque if the cheque is made out to a named payee C and the bank entrusts the cheque to its customer B.

The ABA statement does not apply to cheques drawn by other financial institutions on themselves.

In addition, case law confirms that:

- a payee who gives value for a bank cheque is a “holder for value” as against the drawer bank and later indorsers within sec 37 (¶16-360);
- the payee of a bank cheque needs to provide consideration to be able to enforce a bank cheque;³⁸
- because a bank cheque is considered almost the equivalent of cash, the bank may be estopped from denying the validity of the bank cheque. Furthermore, if a bank advises that a bank cheque is as good as cash, and then dishonours a bank cheque if it is forged, counterfeited, lost or stolen, the bank may be sued for misleading or deceptive conduct under sec 52 of the *Trade Practices Act 1974* (Cth) (¶17-250ff);³⁹

35. With some exceptions, such as “a reference to a cheque in a provision in which a contrary intention appears”.

36. ABA letter published in (1985) 23 LSJ 430, and reproduced in Weerasooria, WS, *Banking Law and the Financial System in Australia*, Butterworths, 4th ed, 1996, [13.82].

37. There was no failure of consideration on the part of D in the *Yan* case below.

38. *Seymour CBD Pty Ltd v Commonwealth Bank of Australia* [1999] QSC 101.

39. *Lyriztis v Westpac Banking Corporation* (1994) ATPR ¶41-360.

- payee B of an ordinary cheque is not a holder in due course because the cheque is issued to payee B, not negotiated to third party C. In contrast, the payee of a bank cheque is person C and is not linked to drawer A (the bank).

For proper protection, a payee, indorsee or drawer (or their agent, such as a solicitor) should obtain special clearance on a bank cheque, telephone the bank at settlement to verify the cheque or, if it is a bearer cheque, convert it to payable to order (§16-250) (thereby putting a heavy onus on the collecting institution if it collects for a party not entitled to the cheque).⁴⁰

Section 5 confirms that (subject to some exceptions) “a cheque includes a reference to a cheque that a financial institution draws on itself”. This means that the various protections against possible legal liability involving cheques are available to the drawee institution (§16-460—§16-520) and to the collecting institution (§16-540).

— *Case examples* —

Mr and Mrs Jacobsen, Americans, opened an account with the Commonwealth Bank by depositing a cashier's cheque (the American equivalent of a bank cheque). From this deposit, they drew funds in a bank cheque which they deposited with a firm of real estate agents. The US authorities froze the funds of the Jacobsens, and their cashier's cheque was stopped, so the Commonwealth Bank stopped payment of its bank cheque. The estate agent sued the bank and the bank joined Mr and Mrs Jacobsen as third parties because they would have to indemnify the bank if the estate agent were successful. The Commonwealth Bank was held not liable to the estate agent because of the failure of consideration given by the Jacobsens for the bank cheque. There was also failure of consideration given by the real estate agent for the bank cheque.⁴¹

— *Sidney Raper Pty Ltd v Commonwealth Trading Bank of Australia*⁴² —

A locked safe containing blank bank cheque forms of the Commonwealth Savings Bank of Australia was stolen when a post office was broken into. Although the theft of the safe was reported to the police, the bank gave no public warning of the theft of the bank cheque forms. When a bank cheque with a forged signature, issued to a trader, was dishonoured by the bank,

40. eg *Lost bank cheques* (1988) 62 LJ 320, ie under sec 23: by indorsing the cheque and by striking out the words “or bearer” and clearly indicating payment to order. See generally Edwards, R, *The form of bank cheques* (1991) 3 Bond LR 174; *Faster clearance of bank cheques won't enhance their status, say banks*, LSJ, Vol 34, No 9, p 78 (October 1996).

41. In *Justin Seward Pty Ltd v Commissioners of Rural and Industries Bank* (1982) 60 FLR 51 at p 59; (1980) 1 SR (WA) 272 at p 278, Acting Judge Clarke (citing

Makim, R, *The Australian bank cheque — some further legal aspects* (1976) 3 Mon LR 66 at p 68) confirmed this principle in the following words: “It would be offensive to simple notions of justice if the holder of the bank cheque who had given no value of some kind in exchange for it and stands to lose nothing by its dishonour were to be able to recover against a banker who had made a mistake.”

42. [1975] 2 NSWLR 227; (1975) 25 FLR 217.

the court held that the bank owed no duty to warn traders in the area about the stolen cheques.

*Johns Period Furniture Pty Ltd v Commonwealth Savings Bank of Australia*⁴³ —

The argument that because the general public treats bank cheques as cash and that banks therefore have a duty to warn a section of the public likely to be affected by stolen bank cheque forms has been rejected in the absence of a relationship of proximity.

*Johnson Matthey Ltd v Australia and New Zealand Banking Group Ltd*⁴⁴ —

A (a rogue) gave B a cheque for \$2m drawn on A's bank in Auckland. B deposited the cheque in his account at Wellington, and later drew a cheque for \$250,000 payable to C. C deposited this cheque with the defendant bank. As agreed between C and A, A withdrew some of the money from C's bank, including a bank cheque for \$50,000 payable to the plaintiff D. In exchange for the bank cheque from A, D gave A \$32,000 cash, believing the \$18,000 difference was to be the deposit for sale of his business to investors that A claimed to represent. A's \$2m cheque was dishonoured, and so was B's cheque for \$250,000, so C did not have the funds in his account to cover the bank cheque of \$50,000. The court held that C's bank must honour its bank cheque to D: any failure of consideration between C and C's bank did not affect D. D had given consideration for the cheque, and the bank was estopped from using C's failure of consideration as grounds for not paying D.

*Yan v Post Office Bank Ltd*⁴⁵ —

¶16-615 Promissory notes. A promissory note is a negotiable instrument in which the maker (the debtor) promises in writing to pay a specified amount to the payee. In contrast, cheques and bills of exchange are orders to pay. Promissory notes must be written (¶15-030). Promissory notes allow the maker of the note to obtain finance by discounting the note with a merchant bank or other financial institution.

Part IV of the *Bills of Exchange Act 1909* (Cth) sets out the main law of promissory notes, subject to the modifications and exceptions contained in sec 95. Section 89 defines a promissory note as:

“an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person, or to bearer”.

Promissory notes can be sued on without the need to prove a pre-existing debt. As with other negotiable instruments, they can be enforced

43. (1980) 24 SASR 224.

44. (1989) Aust Torts Reports ¶180-256.

45. [1994] 1 NZLR 154 (NZ Court of Appeal), noted eg Edwards, R, *New*

Zealand lessons on bank cheques (1994) 5 JBFLP 39; Edwards, R, *Bank cheques* (Rickey Yan) and *letters of credit* (Inflatable Toy Company): a comparison in independence (1997) 71 ALJ 36.

against the drawer by later parties if they have been negotiated to them (§6-270, §16-260). They can be assigned without notice.⁴⁶

By market custom, promissory notes are made payable to bearer and are therefore transferred without indorsement (§16-290). In contrast, bills of exchange are traditionally payable to order and indorsed by the seller whenever transferred. Thus promissory notes remain "one name paper" on which only the maker is liable, whereas bills of exchange have the acceptor primarily liable and a drawer and a number of indorsers who are secondarily liable.

§16-620 Travellers cheques. Travellers cheques are "cheques" which a traveller can buy, often in a foreign currency, for use while travelling. The issuer has the use of the traveller's funds until the cheque is cashed. Some travellers cheques are drawn upon the issuer such as American Express or Thomas Cook: "X bank will pay to the order of ...". Some financial institutions issue travellers cheques drawn upon themselves which are in the form of an order to the financial institution by the traveller, acting as drawer, to pay the amount specified to the order of the traveller: "pay this cheque to the order of ...".

The holder when purchasing the cheques signs them in the presence of the issuing agent; a second signature of the holder must be made on the cheque at the time of cashing it.

— *Case examples* —

Traveller P, carrying £50,000 in travellers cheques in a brown paper envelope which was in a clear plastic bag with 200 cigarettes, fell asleep on the London Underground with the bag resting on his lap. After he had got off the train, he realised that he no longer had the bag. The issuer successfully resisted P's claim for reimbursement of the value of the cheques as he was unable to prove that he had "properly safeguarded each cheque against loss or theft" within the conditions of the contract.

————— *Braithwaite v Thomas Cook Travellers Cheques Ltd*⁴⁷ ———

Traveller P parked his car in an open parking space adjoining his home and left a plastic bag containing £50,000 of travellers cheques in the car overnight. Later the next day he found the cheques were missing. Cheques to the value of £40,700 were later cashed. Unlike the cheques in the previous case, these travellers cheques were not issued subject to a condition requiring safeguarding of the cheques. In contrast, even though he was negligent, P was successful in his claim for reimbursement under an implied term — if not an express term — to the effect that the issuer would refund the amount in the case of loss or theft.

————— *Elawadi v Bank of Credit and Commerce International SA*⁴⁸ ———

46. See further Hewett, J, *The role of promissory notes* (1990) 6 BLB 1. An instrument which allows the promisor to pay at any time before the due date is not a promissory note within sec 89(1) because the uncertainty of the time for

payment destroys its negotiability: *Gore v Octahim Wise Ltd* [1995] 2 Qd R 242.

47. [1989] 3WLR 212; [1989] 1 All ER 235.

48. [1989] 1 All ER 242, noted (1989) 63 ALJ 216.

Banking law authorities are divided on the question whether a travellers cheque has the legal status of a cheque or a negotiable instrument. Whether or not it is a "cheque", it is certainly issued under a contract by the issuer to pay.⁴⁹

ELECTRONIC BANKING

Transfer of funds without paper documents ¶16-650

Electronic funds transfer systems:

current legal status ¶16-660

Electronic funds transfer systems: the issues ¶16-670

¶16-650 Transfer of funds without paper documents.

When the *Bills of Exchange Act* was originally passed (in the UK) in 1882, transfer of funds took place by the use of paper documents such as cheques, bills of exchange and promissory notes. Modern technology has now provided the means of transferring funds without paper by the use of electronic funds transfer systems (EFTS) and other forms of "cybermoney".⁵⁰

EFTS is not regulated by specific legislation, but is subject to relevant legislation such as the *Trade Practices Act 1974* (Cth) and the common law (such as the law of theft: ¶2-330). The financial institution contract with its customer is governed by contract law, and may also be governed by one or more of the Code of Banking Practice (¶16-041) or the Building Society Code of Practice (¶16-041), the Small Business Principles (¶16-042) and the EFT Code of Conduct (¶16-670) if the relevant code has been adopted by the financial institution. All of these Codes — except the Small Business Principles — are administered by ASIC in its jurisdiction over product disclosure, conduct of business and complaints resolution in the financial products of deposit-taking institutions.

Disputes may be referred to the Australian Banking Industry Ombudsman (¶16-045) if the financial institution is a member.

Electronic funds transfer is essentially a process of value exchange by the use of electronic devices brought about by credit or debit orders, of which some of the methods are as follows:

Automatic teller machine transfers. ATMs are electronic terminals which provide many banking services by the insertion of a card and a password or a personal number (known as a PIN — Personal Identification Number). The PIN provides a unique mechanism to identify the person attempting the transaction as the rightful owner of, or as authorised to access, the account. A card without a PIN is unable to access an ATM or an EFTPOS debit account transaction, as such access would be open to abuse if the card were

49. See further Bilinsky, B, *How safe are travellers cheques?* (1990) 1 JBFLP 271, reproduced at (1991) 105 The Australian Banker 7.

50. Tyree, AL, *Digital Cash*, Sydney, Butterworths, 1997; Tyree, A and Beatty, A, *Digital cash in Australia* (1998) 9 JBFLP 5.

lost or stolen. However, credit card accounts can be accessed without PINs through EFTPOS and MDC terminals by the customer's signature.

E-cash. E-cash is a digitally encoded "coin" which a customer can withdraw from a bank over the Internet on to the customer's hard disk, and then send over the Internet to others. It is instantaneous and inexpensive. At this stage there is no regulation of e-cash.

Electronic Data Interchange (EDI). EDI is "paperless trading" — the electronic business to business exchange of communications such as sales orders and shipping documents from computer to computer without human intervention. EDI reduces paper documentation and allows for the automating of commercial transactions.

Paper-free banking. The installation of PIN pads and swipe readers at branch front counters eliminates the need for paper vouchers to be made out for simple transactions (like cash deposits and withdrawals) on card accessed accounts when making these transactions over the counter. As with ATMs, the mechanism for customer identification in lieu of a signature is the input of the correct PIN for the card presented. Other methods of electronic identification exist (eg signature dynamics or handprints) but are not yet in use in Australia.

Point of sale transfers. Debit cards rather than credit cards were currently more widely used in EFTPOS terminals in supermarkets and other outlets, but this is no longer the case as:

- (1) credit card processing systems are no longer more expensive to develop and maintain than debit card systems; and
- (2) financial institutions no longer discourage the use of credit cards for the purchase of food and other supermarket items. Today most supermarkets have EFTPOS terminals that support debit and credit cards, and credit card loyalty programs have been very successful in generating a big increase in credit card sales volumes partly based on supermarket usage.

Retailing in Australia is witnessing the expansion of payment by transfer of funds from the customer's bank account to the seller's account by POS device at the outlet. A national EFTPOS network (electronic funds transfer at point of sale) involving the POS networks of banks and non-bank financial institutions has developed as agreement has been reached for the electronic linking of networks to provide for interchange of their respective cardholders' transactions (debit and credit) at other terminals.

Smart cards/stored value cards. These are credit card sized plastic cards which are essentially electronic cash — they are a micro-processor which stores financial and other data and enables the carrying out of small transactions electronically such as the purchase of goods and services from authorised merchants until the stored value expires (in the case of a disposable card). Some stored value cards can be reloaded with value from a linked transaction account. Smart cards will not become more common in the payments system until they become a business proposition.

Transfers initiated by telephone. This facility allows the customer to phone the institution holding its account and, by giving a code or other form of

identification, instruct the institution or third party to withdraw funds from the account to pay an amount owed by the customer. This includes "home" or "office" banking offered by some institutions, and BPAY, which has the potential to dominate this market.

Virtual cash — payments on the Internet. The current method of payment on the Internet for goods and services by credit card has problems of authentication and security, but efficient and secure funds transfer without paper on the Internet is not far away.

¶16-660 Electronic funds transfer systems: current legal status. The contract between financial institutions and their customers is regulated by many areas of law (¶16-040ff; ¶16-650) including the Electronic Funds Transfer (EFT) Code of Conduct, which sets out procedures governing the relationship between the users and the providers of EFT systems.

The current EFT Code, which came into operation in 1999 following a review by the Commonwealth Treasury and the ACCC, is monitored by ASIC.⁵¹ ASIC ensures that financial institutions comply with the code and especially targets product disclosure, conduct and complaints resolution.

ASIC released a Working Paper in 1999 calling for the EFT Code of Conduct to be expanded beyond its current coverage of ATM and EFTPOS transactions to ensure that it covers all forms of electronic transactions, including all means of remote account access such as telephone, computer dial-up and Internet banking and stored payment systems.⁵²

¶16-670 Electronic funds transfer systems: the issues.

The rights and obligations of the parties involved in electronic transfers appearing in the contractual relationship between the parties give rise to several legal problems.⁵³ In an attempt to clarify the relationship between users and providers (card-issuers) of EFT systems, the EFT Code of Conduct (¶16-660) provides:

(1) *Coverage* — the procedures apply to transactions by an individual through an electronic terminal by means of an EFT card and PIN. (The code does not apply to EFT by telephone and personal computer, and transactions with pre-paid "smart cards" because they do not involve one or more of the three essential prerequisites — an electronic terminal, a card and a PIN).

51. The first EFT Code of Conduct was contained in recommended voluntary guidelines issued in 1986 prepared by a working group chaired by the Commonwealth Treasury. Financial institutions were asked to review their procedures in line with the recommendations of the working group — under threat of legislation if they did not — and 1987 saw widespread reissuing of EFT conditions of use. The 1986 Code

was replaced in 1989 by the EFT Code released by the federal Minister for Consumer Affairs which was in turn replaced by the current 1999 Code.

52. The Code and current proposals are available on the ASIC homepage at www.asic.gov.au.

53. eg Carver, L, *How to win an electronic funds transfer dispute*, Melbourne, Consumer Credit Legal Service, 1991.

(2) *Availability and disclosure of the terms and conditions of use applicable to EFT transactions* — clear, readily available and unambiguous terms and conditions of use, highlighting charges, restrictions, etc. Copies of the terms and conditions of the code are to be readily available, and card-issuers are to publicise their availability. The terms and conditions of use are to include a warranty that the requirements of the code will be complied with.

(3) *Changing the terms and conditions of use* — Cardholders are to be notified of changes to their EFT terms and conditions. Some variations require the giving of 30 days' written notice, whereas other variations need only be notified in advance (by alternative methods). When advising an increase in a cardholder's periodic transaction limit, card-issuers are to give clear and prominent advice to the cardholder that such increase may increase their liability for unauthorised transactions.

(4) *Paper records of EFT transactions* — unless a cardholder specifically elects otherwise, a receipt is to be issued at the time of an EFT transaction and a statement of account at least every six months (more frequently if requested). Card-issuers must include on or with account statements at least annually a clear, prominent and self-contained statement summarising card and PIN security requirements.

(5) *Cardholder liability for unauthorised transactions.* The cardholder has no liability in respect of fraudulent or negligent conduct of card issuers' employees or agents; forged, faulty, expired or cancelled cards; losses occurring prior to receipt of card and PIN; losses that are caused by the same transaction being incorrectly debited more than once to the same account (EFT Code, clause 5.2(iv)); unauthorised transactions occurring after notification to the card issuer that the card has been lost or stolen, etc or where it is clear that the cardholder has not contributed to the loss. Where it is unclear whether the cardholder has contributed to losses resulting from unauthorised transactions, the cardholder's liability is limited to the lesser of:

- (a) \$50 (or other contracted figure); or
- (b) the balance of the cardholder's account(s) (including any prearranged credit); or
- (c) the actual loss at the time the card issuer is notified of the loss or theft of the card.

In determining whether or not a cardholder has contributed to the loss, the card-issuer is to consider all reasonable evidence, including all reasonable explanations for the transaction occurring. The fact that the account has been accessed with the correct PIN, while significant, will not of itself be conclusive evidence that the cardholder has contributed to the loss. Where the cardholder has contributed to losses resulting from unauthorised transactions, by PIN disclosure to anyone, including a family member or friend, by compromising PIN security in the ways mentioned in clause 5.6 of the code or by unreasonably delaying notification of the misuse, loss or theft of the card, the cardholder is liable for the actual losses which occur before the card issuer was notified, except for:

- (a) that portion of the losses incurred on any one day which exceeds the daily transaction limit applicable to the card or account(s); or
 - (b) that portion of the total losses incurred which exceeds the balance of the cardholder's account(s) (including any prearranged credit).
- (6) *Liability in cases of technical malfunction* to be borne by the card issuer except where the cardholder should have been aware of the malfunction.
- (7) *Deposits at electronic terminals*—
- (a) Where there are discrepancies between recorded deposits and amounts received, the cardholder should be notified of the difference as soon as possible and should be advised of the actual amount credited to the account.
 - (b) The security of deposits received at electronic terminals is the responsibility of the financial institution from the time when the terminal transaction is completed.
- (8) *Networking arrangements*. Failures within a shared EFT system do not excuse card issuers from their obligations.
- (9) *Audit trails* are to exist by way of sufficient records to enable transactions to be traced.
- (10) *Privacy* is to be maintained.⁵⁴
- (11) *Complaint investigation and resolution procedures* — formal complaints resolution procedures are provided. After the card issuer has advised the cardholder of the outcome of its investigation together with reasons for that outcome, the cardholder may request that the decision be reviewed by senior management. Where an investigation continues beyond 45 days, card-issuers are to provide the cardholder with monthly updates on the investigation and the date when a decision can be reasonably expected. Card-issuers are to advise of external complaint resolution avenues — Consumer Affairs agencies (§17-880), Small Claims Courts/Tribunals (§17-690ff), and the Australian Banking Industry Ombudsman (§16-045).

CARDS

The rise of cards	¶16-680
The operation of cards	¶16-690
The legal relationship between financial institution and merchant	¶16-710
Cardholder's liabilities and rights	¶16-740
Conditions of use	¶16-750

54. Compare the *Privacy Act 1988* (Cth) and its eleven Information Privacy Principles, designed to protect people from intrusions into their personal privacy by

Commonwealth government agencies: noted (1989) 63 ALJ 116; (1989) 63 ALJ 285; [1989] Reform 21; Wilson, K, *Privacy and computer law* (1991) 65 LJ 461.

¶16-680 The rise of cards. Technically speaking, a “charge card” is a card such as American Express or Diners which does not charge interest but which requires the monthly bill to be settled in full on receipt (although some have extended payment plans). A “credit card”, such as Visa or Bankcard, enables the cardholder to defer full payment of principal from one month to the next on payment of a minimum percentage of the outstanding balance, generally covering the interest charge, government duties and part of the principal debt. The following paragraphs generalise the law on all cards under the generic “cards”.

Although credit coins, retailers’ credit accounts and accounts with the corner grocer have been around for many decades (the first case was in 1915 and concerned misuse of a credit coin), it is really only in the post-World War II period that cards have come into wide use. Diners Club, founded in the US in 1950, was followed in 1958 by American Express.

Australia followed the card trend in 1974. The American Express Card billed in Australian dollars was launched in February 1974, followed by the Bankcard scheme which was launched in October 1974 by a consortium of nine banks. Bankcard, MasterCard and Visa card have a major share of the Australian market. All three credit card schemes use similar vouchers and have similar rules and generally standard requirements for merchant agreements in respect of the three cards. Millions of cards are on issue in Australia, which are accepted at millions of outlets throughout the world.

¶16-690 The operation of cards. There are differences between the card conditions of different financial institutions and, in response to market forces, card details are always changing.

Bankcard and other credit cards normally involve three or sometimes four parties: the cardholder (the buyer, who pays the issuer in line with the statement), the merchant, and the financial institution — the cardholder’s financial institution (the issuer) and the merchant’s financial institution (the acquirer). The acquirer is reimbursed by the issuing financial institution through the interchange.

Within the three party or tripartite system there are three sides but four contracts:

- (1) the agreement between the issuer and the cardholder;
- (2) the merchant agreement between the merchant and the merchant’s financial institution or organisation with which the merchant is affiliated;
- (3) a sales agreement, ie a purchase between the cardholder and the merchant;
- (4) a reimbursement agreement between the merchant’s financial institution and the cardholder’s financial institution via a clearing intermediary.

A cardholder enters an agreement with the issuer which enables the cardholder to incur obligation to the issuer by the purchase of goods and services. A typical agreement provides two main options: the cardholder may pay for goods and services within a specified period after the monthly

statement date without incurring any additional charge (taking advantage of an interest free period); or the holder may defer full payment, in which case the holder becomes a borrower with respect to the issuer and will incur charges and other obligations according to the agreement.

Cards offering an interest free period on credit purchases usually charge a higher rate of interest than those which do not.

Interest free periods do not apply to cash advances, so interest charges accrue from the date the transaction is debited to the cardholder's account until the amount is paid in full.

Merchants/suppliers accept the cardholder's production of the card and signing of a voucher as absolute discharge of the cardholder's obligation to pay for the goods or services supplied. Electronic transactions/processing have replaced paper-based vouchers in many instances. Although "vouchers" are still used, merchant agreements generally refer to "sales transactions".

The merchant's financial institution (not the cardholder's financial institution — the issuer) is responsible for making payment to the merchant. It is reimbursed by the issuer. If a merchant does not present a valid sales voucher to its financial institution (eg it presents a voucher which is not signed or not imprinted) the issuer cannot debit its cardholder's account. The transaction is charged back to the merchant's financial institution which in turn debits the merchant. The merchant must then contact its customer to obtain payment.

¶16-710 The legal relationship between financial institution and merchant.

In the case of credit cards, the relationship with merchants is contained in a generally standard form contract. Many similar provisions are found in the merchant agreements of the various merchant acquirers, since the card scheme rules specifically state that merchant agreements are to contain them. Additional matters can be covered in the contract between the acquirer and the merchant, as long as these are not inconsistent with the mandatory provisions.

One typical clause sets out the numerous undertakings of the merchant, which include undertakings:

- to honour all valid cards presented by supplying goods and services;
- to use reasonable care to detect forged/unauthorised signatures;
- to permit the financial institution to debit the merchant's account with all relevant charges, etc; and
- to permit the financial institution to inspect books of accounts and records relating to card transactions.

In return, the financial institution undertakes to credit the merchant's account with the face value of the valid sales vouchers. Payment for risk is contained within the merchant service fee. The merchant is able to pass much of the bad debt risk for card sales to the financial institution, but some risks cannot be passed on. For example, in mail and telephone transactions, the

merchant still bears the risk of fraud, or of chargebacks for other reasons such as non-receipt of goods and supply of incorrect order. Going through the proper authorisation process will protect the merchant against bad debt risk, but will not constitute a guarantee of payment.

¶16-740 Cardholder's liabilities and rights. The financial institution/cardholder relationship is governed by common law principles to be read in the light of the Code of Banking Practice (¶16-041), the EFT Code of Conduct (¶16-670), the jurisdiction of the Australian Banking Industry Ombudsman (¶16-045) and legislation such as the *Trade Practices Act 1974* (Cth).

Currently the EFT Code of Conduct only applies to transactions by credit card if made through an electronic terminal accessed by a PIN. (This has been under review in 2000: ¶16-660.) For example, booking concert tickets over the phone on a credit card is currently not covered by the Code.⁵⁵

Cardholder's liabilities. The cardholder's liability to the issuer is regulated by a written contract contained in the literature accompanying the card or in an application form. If deferred payment is permitted and the card is for personal use, the conditions of use are regulated by the Consumer Credit Code: ¶14-150.

A card's "conditions of use" make up the terms of the contract between the cardholder and the cardholder's financial institution or other issuer. As with all standard form conditions, these must be clearly brought to the cardholder's attention before the credit card contract is made (¶6-180ff).

If a credit card is lost or stolen, the conditions of use (¶16-750) require the cardholder to notify the financial institution or issuer "immediately" or "as soon as possible". Compliance with this condition is critical, as the cardholder has no liability for losses resulting from unauthorised transactions occurring after notification to the card-issuer of misuse, loss or theft of the card (under clause 5.3 of the EFT Code of Conduct: ¶16-670, point (5)).

The EFT Code of Conduct does not expressly state that failure to observe basic security requirements may lead to increased liability for unauthorised use, though the code certainly implies that card and PIN security are important — for example, clause 4.5 requires card-issuers to provide annual security advices on or with statements, and clause 5.6 states that failure to observe security requirements could lead to increased liability.

Cardholder's rights. If the goods supplied prove to be defective, the cardholder may sue the merchant under the *Trade Practices Act 1974* (Cth) (¶7-250ff), the *Sale of Goods Act* (¶7-012ff) and/or at common law in contract or tort.

55. eg Edwards, R, *The credit card as Cinderella — or should the EFT Code cover credit cards?* (1999) 15(3) BLB 40.

In limited circumstances a cardholder may be able to sue the merchant and the card-issuer jointly because the consumer credit legislation imposes the obligation of a linked credit provider on a credit issuer if there is an arrangement with the merchant that the merchant would recommend or induce the buyer to take out a credit card with the financial institution to purchase the goods or services from the merchant (§14-210). In most instances, those buying goods or services with a credit card already have a credit card, so the credit provider would come within the defence that the credit was provided by the credit provider as a result of an approach by the buyer which was not induced by the merchant.

¶16-750 Conditions of use. Credit card conditions of use are given to each new cardholder, and use of the card is specified to be an indication of the holder's agreement to those conditions.⁵⁶

Most charge cards and credit cards are regulated "continuing credit contracts" under consumer credit legislation (§14-150). Section 14 of the Consumer Credit Code requires that the continuing credit provider must, before the continuing credit contract is entered into, give the cardholder (debtor) a precontractual statement setting out the matters required by sec 15 to be included in the contract document, as well as a statutory information statement (§14-180).

Cardholder exceeding credit limit. One condition of the credit card conditions of use is that a cardholder will not exceed the credit limit authorised by the financial institution. To attempt to do so may infringe the criminal law.⁵⁷

56. In its monitoring report on credit card pricing (§16-020: 1995), the Prices Surveillance Authority (now the ACCC) was concerned about the rise in credit card interest rates during 1995, and the lack of clear disclosure of the different ways in which banks calculate interest.

57. eg computer crime: §2-300; *Director of Public Prosecutions v Murdoch* [1993] 1 VR 406 (computer trespass); false pretences; *R v Lockett* (1980) 27 ALR 444 (conviction); *Jacobson v Piepers*; *Ex parte Piepers* [1980] Qd R 448 (two years' good behaviour bond and probation).

Chapter 17

Insurance

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DEFINITION AND NATURE OF INSURANCE _____

Definition of insurance	¶17-020
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¶17-020 **Definition of insurance.** Insurance is an important requirement of business to provide cover against losses of various kinds — life or contingency, general or indemnity, and industrial. A policy of insurance is a contract under which one party (the insurer) agrees, in return for a consideration, to indemnify another (the insured) for loss suffered as a result of the occurrence of a specified event. Insurance is regulated by legislation,¹ and case law principles going back many centuries.

¶17-035 **Reform of insurance law.** Many principles of insurance law were developed in the eighteenth century, when insurers and insureds were mostly drawn from the same class of merchants (whose main meeting place was Lloyd's Coffee House in London). The earliest policies did little more than specify the names of the insurer, the insured and the risk; the obligations of the parties depended on mercantile custom (ie usage: ¶6-120).

The Commonwealth government has been involved in the regulation of the general insurance and life insurance industries for many years. It has regulated the contractual relationship between insurer and insured in the case of marine insurance since 1909.² Only in recent years, however, has the Commonwealth chosen to exert its constitutional authority (under sec 51(xiv) of the Constitution: ¶1-475—¶1-480) and involve itself in the reform and regulation of the law relating to contracts of insurance.

Insurance Contracts Act 1984 (Cth) and the Insurance (Agents and Brokers) Act 1984 (Cth). Both of these Acts³ resulted from recommendations made by the Australian Law Reform Commission ("ALRC")⁴ and are the basis of Australian insurance law.

One of the principles which guided the ALRC in making its recommendations in its report on *Insurance Contracts* was the promotion of informed choice by people taking out insurance.⁵ The legislation is remedial and is designed to reform the pre-existing law of insurance.

"According to the Commission, the 'central problem' of the remedies provided by the pre-existing law, in a case of non-disclosure of a material fact both before a contract of insurance was entered and arising during a period of cover, was the 'disproportion' between the loss to the *insured* where the insurance contract was avoided, normally after the loss had occurred (on the

1. *Marine Insurance Act 1909* (Cth); *Insurance (Deposits) Act 1932* (Cth); *Life Insurance Act 1995* (Cth); *Insurance Act 1973* (Cth); *Insurance Contracts Act 1984* (Cth); *Insurance (Agents and Brokers) Act 1984* (Cth).

2. eg *Marine Insurance Act 1909* (Cth).

3. The *Insurance Contracts Act* commenced in 1986. The *Insurance (Agents and Brokers) Act* commenced 1984-1988.

4. *Insurance Agents and Brokers* (ALRC 16, 1980) and *Insurance Contracts* (ALRC 20, 1982). The two reports were the result of a reference in 1976 from the federal Attorney-General. In certain circumstances the courts may consider the ALRC reports and draft Bills in interpreting the Acts: sec 15AB *Acts Interpretation Act 1901* (Cth) (¶1-550).

5. ALRC 20, *Insurance Contracts*, p xxi.

one hand) and the prejudice to the *insurer* occasioned by the non-disclosure (on the other).”⁶

The *Insurance Contracts Act 1984* (Cth) is not intended to codify the law; therefore State, Territory and Commonwealth Acts and the common law and equity will continue to apply unless expressly or impliedly excluded by the Act (sec 7).

The legislation does not apply to (sec 9):

- reinsurance;
- medical and hospital insurance written by an organisation registered under the *National Health Act 1953*;
- insurance entered into, or proposed to be entered into, by a friendly society or the Export Finance and Insurance Corporation;
- marine insurance;⁷
- workers’ compensation insurance;
- compulsory third party motor vehicle insurance; and
- State insurance and Northern Territory insurance, ie contracts entered into by State Government Insurance Offices and the Territory Insurance Office as the insurer or as joint insurer with another insurer.

A provision in an insurance contract which permits the insurer to vary the contract to the prejudice of any other person is void (sec 53). The *Insurance Contracts Act* cannot be excluded unless expressly authorised by the Act (sec 52). For example, an Australian policy said to be governed by the laws of England would be overridden by sec 52 so that the remedial provisions of the Act (such as sec 54: ¶17-640) could apply.⁸

Administration. The Australian Prudential Regulation Authority (APRA) is responsible for the prudential regulation of superannuation, insurance and deposit-taking institutions. The Australian Securities and Investments Commission (ASIC: ¶9-380; ¶17-310) is responsible for consumer protection across the financial system. The *Insurance Contracts Act 1984* Pt 1A (Administration) provides that ASIC is responsible for the general administration of this Act.

¶17-036 Insurance Codes of Practice. Codes of practice for the general and life insurance industries establish minimum standards of good insurance practice.

6. *Commercial Union Assurance Company of Australia Ltd v Ferrcom Pty Ltd* (1991) 22 NSWLR 389, per Kirby P at pp 391-392; (1991) 6 ANZ Insurance Cases ¶61-042 at p 76,988.

7. With the exclusion of “pleasure craft”: ¶17-050n.

8. *Akai Pty Ltd v The People’s Insurance Co Ltd* (1996) 71 ALJR 156; (1997) 9 ANZ Insurance Cases ¶61-347 (High Court struck down “choice of forum” clause designed to evade the Act).

The General Insurance Code of Practice, which applies to general insurers, came into force in 1995. This is a voluntary, industry based code, released by the Insurance Council of Australia and administered by the Australian Securities and Investments Commission (ASIC).⁹

The Life Insurance Code of Practice applies to life insurers and life brokers, in respect of their conduct and the conduct of their life insurance advisers. The code was launched in 1995.

These two codes parallel the Code of Banking Practice (1993: ¶16-041) and address many of the same issues:

- (1) Improved product disclosure and policy documentation, so that consumers can make informed choices.
- (2) Improved standards of service including minimum standards on claims handling procedures.
- (3) Dispute resolution. The codes require each insurer to have an Internal Dispute Resolution System (IDR) in place, and they require an insurer which cannot settle a complaint to refer it to a recognised external scheme (¶17-810).

The General Insurance Brokers' Code of Practice is part of a national self-regulatory scheme. All brokers participating in the scheme are bound by the code. The code is intended to promote efficiency in transactions by describing standards of good practice and service to be expected from general insurance brokers.

All the insurance codes of conduct are administered by ASIC (¶9-380; ¶17-310) under its expanded consumer role.

PARTICULAR CONTRACTS OF INSURANCE _____

Contingency or life insurance	¶17-040
Indemnity or general insurance	¶17-050
Workers' compensation	¶17-065

¶17-040 Contingency or life insurance. Under a contract of contingency insurance, the insured pays a premium in return for the insurer's promise to pay an agreed amount if a specified event such as death happens. Contingency (or life) insurance includes life insurance, accident insurance and sickness insurance.

Life Insurance.¹⁰ The main types of life insurance are as follows:

- (1) "Whole of life" insurance.
- (2) Term or temporary insurance.

9. Available at www.ica.com.au.

10. In life insurance the terms "assurance" and "assured" are commonly used for,

respectively, "insurance" and "life insured"; however, the latter have been retained in this chapter for consistency and clarity.

(3) Endowment insurance.

(4) Annuities.

Most popular and common life products are “unbundled”, and consist of aspects of classes (1) to (4).

(1) *“Whole of life” insurance.* A “whole of life” policy offers immediate and continuing death cover, for a specified sum, in return for a yearly premium which is calculated by reference to the number of years the life insured is expected to live. An example is “key executive” or “key employee” life insurance, purchased by a business on the life of an owner or employee to offset the loss of that person’s services and the need for future reorganisation.

Life policies usually have a “cash value” which is paid to the insured if the insured elects to surrender the policy. They also usually contain a minimal investment element in the form of reversionary bonuses. These are monetary additions made to the policy, usually yearly, out of the surplus profits of the insurer. The longer the life insured survives, therefore, the greater the amount payable upon the life insured’s death.

(2) *Term or temporary insurance.* Term insurance provides death cover during a specified period only. If the life insured survives to the end of that period, no amount is payable by the insurer. These policies do not contain any investment element.

(3) *Endowment insurance.* A contract of endowment insurance provides for the payment of a lump sum if the life insured survives to the end of the specified period. The contract will also usually provide death cover, for a specified sum, during that period and will usually have a “cash” value payable upon surrender. Reversionary bonuses may be declared during the life of the policy. Thus endowment policies provide both investment and protection.

(4) *Annuities.* With an annuity, the insurer agrees to make payments at regular intervals to the recipient (the annuitant). An annuity may be certain (payments for an agreed period), for life (until the death of the insured) or joint (until the death of the survivor of two persons).

In contrast to indemnity insurance (§17-050):

- life insurance does not provide for indemnity (§17-300), and
- the doctrine of subrogation does not apply to life insurance (§17-920).

Personal accident, disability and sickness insurance. The term “life insurance” also applies to contracts providing protection against the economic consequences of sustaining an accident or succumbing to an illness. Some of these policies provide death cover and all limit the events in respect of which liability can arise. For example, most policies exclude cover where the event was intentionally caused by the insured or is the result of sexually transmitted diseases. Further, many policies link the amount recoverable to the insured’s salary and provide that after a stated period no further payments are payable. There are also differences between policies as to the circumstances under which the insured is deemed to be fit again so that payments under the contract are no longer payable. In some instances, for example, payments

will cease once the insured is capable of being employed again, whereas other policies provide that payments shall continue in such circumstances if the insured is unable to recommence the previous employment.

Standard cover has been prescribed for sickness and accident insurance by the *Insurance Contracts Regulations* (Cth) (see ¶17-610).

¶17-050 Indemnity or general insurance. Under a contract of indemnity (or general or property¹¹) insurance, the insured pays a premium in return for the insurer's promise to make good loss or damage from specified perils such as fire, burglary, theft and fraud, goods in transit, livestock, plate glass, engineering insurance (eg boiler and pressure vessel insurance), and pecuniary loss (eg loss of profit and default of a debtor). All are contracts of indemnity as they seek to protect the insured against the consequences of injury to the insured's proprietary interests. Some of the more important types of indemnity insurance include the following.

Property insurance

Cash in transit policy. Under this type of policy the insured is provided with protection against the loss of money by theft or otherwise, provided only that at the time of the loss the money is in transit between designated locations such as the insured's place of business and its bank. Such a policy will not usually cover losses arising at other locations even though the insured has acted reasonably in taking the money to that other location.

Loss of profits or business interruption or consequential loss policy. Under this policy the insurer agrees to indemnify the insured for economic loss resulting from the disruption of the insured's business following damage caused by an insured peril. (Ordinary fire policies, for example, do not cover loss of profits.) Clearly, such policies are of vital importance to any business enterprise and accordingly care must be taken in selecting a policy which provides adequate cover to the insured.

Fidelity guarantee (embezzlement) insurances. A fidelity guarantee insurance provides an insured with protection against the defalcations of its employees. Usually such policies limit the time within which a claim can be made to, for example, six months of the actual date of the defalcation, thus placing a premium upon the insured's surveillance procedures and accounting records.

11. Marine insurance is not classified as "property insurance". Although the insured usually seeks to protect its interest in the ship or cargo, ie "property", marine insurance is generally regarded as a separate topic. However, many of the basic principles of insurance law apply to marine insurance, eg insurable interest (see ¶17-205ff), indemnity (see ¶17-260ff) and good faith (see ¶17-310ff), although codified in the *Marine Insurance Act 1909* (Cth). The various States have

corresponding legislation concerning State marine insurance not extending beyond the limits of the State concerned. The *Insurance Contracts Act 1984* (Cth) does not apply to contracts of marine insurance (sec 9(1)), with the exception of a contract of marine insurance on "pleasure craft" (sec 9A: added 1998) defined to mean a "ship" that is used "wholly for recreational activities, sporting activities, or both ... otherwise than for reward".

Fire insurance. A fire policy simply provides protection against damage to or destruction of property (real or personal) due to fire. There must in fact be ignition of the property insured or of the premises where it is situated. Thus if property is damaged by excessive heat from a fire but is not actually ignited, the damage is not within the terms of a fire policy (subject of course to the specific provisions of the policy). A fire policy may also provide cover against extraneous perils such as explosion, storm and tempest, lightning, aircraft, earthquake, water damage and sprinkler leakage. Damage and loss caused by fire brigades while fighting fires is within the terms of all fire policies, under State and Territory fire brigades legislation. It is immaterial whether the fire comes to the insured property or the insured property comes to the fire and the insured will be able to recover if the insured deliberately lights the fire, but with no intention of destroying the property. Negligence will not generally affect the insured's right to recover under the policy; indeed one object of a fire policy is to protect the insured against the consequence of negligence.

Liability insurance

Consumer credit insurance. Consumer credit insurance is designed to protect a consumer's ability to meet the loan repayments on personal loans and credit card finance in the event of death, disability or loss of income due to injury, illness or unemployment. Standard cover has been prescribed under the *Insurance Contracts Regulations* for consumer credit insurance (¶17-610).

Section 71A of the *Insurance Contracts Act* provides for pre-sale, point of sale and post-sale information about the insurance to be given by insurers to purchasers of consumer credit insurance products. Section 64A provides for a post-sale 14-day cooling-off period for purchasers of consumer credit insurance.

The Consumer Credit Code regulates the duties, liabilities and rights of parties to credit-related insurance contracts — consumer credit insurance, and insurance over property mortgaged to a credit provider (¶14-150).¹²

Legal expenses insurance. This insurance indemnifies persons against unexpected legal expenses. Long regarded as unnecessary, legal expenses insurance is now of special benefit to middle-income earners who do not qualify for legal aid (¶7-760).

Product liability insurance. The purpose of a product liability policy is to provide the insured with protection against losses arising out of the defective nature of the insured's products. The protection usually extends to losses arising out of bodily injury or property damage sustained by third parties as a result of use of the insured's products. Product liability insurance is now especially important with ever increasing manufacturers' liability under tort and the *Trade Practices Act 1974* (Cth) — especially Part VA (¶7-215).

12. See further Bond, C, *How to win a consumer credit insurance dispute*,

Melbourne, Consumer Credit Legal Service, 1991.

Professional indemnity insurance. Professional people in the business of giving advice and acting on behalf of others, for example lawyers, doctors, accountants, insurance brokers and stockbrokers, effect professional indemnity insurance to cover legal liability resulting from their negligence or a breach of their duty of care (§4-230ff). In many cases such insurance is compulsory under State or federal legislation. For example, registered insurance brokers (§17-590) must have such insurance.

Public liability insurance. All businesses should have public liability insurance to protect them against claims arising from personal injury or property damage caused to third persons by the actions and operations of the insured.

Motor vehicle insurance

Motor vehicles — compulsory third party insurance. Legislation exists in Australia¹³ compelling all motor vehicle owners to insure themselves and anyone else driving the vehicle against liability incurred in respect of the death of or bodily injury to persons caused by or arising out of the use of the vehicle. If the insured cannot satisfy any judgment the injured party may generally recover direct from the insurer; if the owner or driver of the vehicle cannot be found or is not insured the injured party may proceed against the “nominal defendant”.

“No-fault” schemes. A scheme has been established in Victoria¹⁴ which effectively bypasses the concept of insurance (§7-730). A statutory body called the Transport Accident Commission handles all claims for compensation where a person is injured or killed in a transport accident (not just motor vehicle accidents), and the right to sue for damages at common law, though retained, is severely restricted by sec 93; “no-fault” benefits are payable. Tasmania and the Northern Territory have also established “no-fault” schemes, with the abolition of common law rights under the Northern Territory scheme.¹⁵ Insurance policies as such do not exist under these schemes, although the statutory bodies will indemnify the owners and drivers of registered motor vehicles who are liable to pay damages under the laws of another State or Territory. New South Wales’ TransCover third party insurance scheme, introduced in 1987, was replaced in 1989 with a common law based scheme for recovery of damages for personal injury or death caused by a motor vehicle (with maximum damages specified).¹⁶ Compulsory third

13. *Motor Vehicles (Third Party Insurance) Act 1942* (NSW); *Motor Accident Insurance Act 1994* (Qld); *Motor Vehicles Act 1959* (SA), Pt 4; *Motor Vehicle (Third Party Insurance) Act 1943* (WA); *Motor Accidents (Liabilities and Compensation) Act 1973* (Tas); *Motor Traffic Act 1936* (ACT), Pt V; *Motor Vehicles Act 1949* (NT), Pt V; *Motor Accidents (Compensation) Act 1979* (NT). See eg *Seminar in print — road trauma* (1987) 61 LIJ 670.

14. *Transport Accident Act 1986* (Vic).

15. *Motor Accidents (Liabilities and Compensation) Act 1973* (Tas); *Motor Accidents (Compensation) Act 1979* (NT).

16. *The Motor Accidents Act 1988* (NSW) commenced July 1989: eg Cameron, J, *The Motor Accidents Bill 1988*, LSJ, Vol 27, No 1, p 43 (February 1989).

party motor vehicle insurance is excluded from the *Insurance Contracts Act 1984* (Cth) (sec 9(1)(e)).

Motor vehicle insurance — property. Comprehensive motor vehicle insurance provides cover in respect of claims by third parties in relation to property damage, for example to the third party's vehicle, as well as in respect of accidental loss or damage, including by theft and fire, to the insured's own vehicle. Indemnity will not be provided if the vehicle is being driven by a person who, or is being used for a purpose which, is excluded by the policy. Standard cover has been prescribed by the *Insurance Contracts Regulations* for motor vehicle property damage insurance (see ¶17-610).

Standard cover — domestic insurances. Standard cover has been prescribed for five key areas of domestic insurance — motor vehicle (property damage only), home buildings and contents, sickness and accident, consumer credit and travel: *Insurance Contracts Act 1984* (Cth) sec 34-36; *Insurance Contracts Regulations* (see ¶17-610).

¶17-065 Workers' compensation. All employees in Australia must be insured by their employer for workers' compensation. A premium or levy is payable, usually annually, based on experience rating calculated according to the nature of the industry and its past injury record. Self-insurance is available in some States. Workers become entitled to workers' compensation benefits if they suffer injury or disease arising out of or in the course of employment.

Whether an injury or disease occurred "in the course of employment" is determined by examining the sphere of the work carried out rather than whether an employee was on the employer's premises at the time of injury; it is usually extended by specific statutory provisions, such as the standard "journey" provision (generally covering an employee who is travelling between home and the place of employment, and certain other places such as educational institutions).

Specific legislation providing for workers' compensation benefits exists at the federal level (Comcare covering Commonwealth government employees, and the *Seafarers Rehabilitation and Compensation Act 1992* (Cth) covering certain seamen) as well as in all States and Territories. Workers' compensation is excluded from the operation of the *Insurance Contracts Act* (sec 9(1)(e)).

In all jurisdictions the existence of an employment relationship or deemed employment relationship is a condition of entitlement. Any person working under a contract of service or apprenticeship or otherwise with an employer in whatever capacity is an employee, regardless of whether the contract is express or implied, oral or in writing. It is a question of fact whether a seemingly independent contractor (under a contract of services: ¶11-020) is deemed to be an employee under the various statutes. The court or tribunal will look at the degree of control the worker has over when, where and how the work is done.

An injured employee may be entitled to other remedies rather than workers' compensation benefits:

- (1) sick leave as provided by the industrial award or employment agreement;
- (2) some form of social security payment;
- (3) a common law claim for damages.

Workers' compensation may displace sick leave and some social security payments. In addition, social security payments may be repayable on receipt of workers' compensation benefits. Common law damages are available in some jurisdictions, and receipt of an award may also result in repayment of workers' compensation benefits.

Benefits are in general paid during the period an employee is incapable of working. The amount will vary in certain jurisdictions according to the number of dependants, and in others according to the payments formula. Medical and hospital expenses are also met. In cases of death, provision is made for lump sum payments. Certain permanent disabilities are compensated by a lump sum (under the "Table of Maims"). There is also provision in some jurisdictions for redemption of weekly benefits by a lump sum.

Although benefits are granted in most cases of injury, an employee can bar entitlement through factors such as serious or wilful misconduct causing the injury, or a substantial deviation from or interruption of a journey otherwise within the course of employment.

The traditional insurance approach to workers' compensation has largely been replaced, with the emphasis now on occupational health and safety, accident prevention, rehabilitation and financial compensation to injured workers and their dependants. The various systems are founded on the principles that an employee should be provided with a safe and healthy working environment; that injured employees should receive prompt earnings-related income support determined according to their *needs* not the *causes* of their disabilities; that legal adversary procedures with their inherent delays and costs should be avoided and replaced with proceedings before a Commission (or the like); that there should be ready access to rehabilitation to restore injured workers to the fullest vocational and economic, etc functioning (eg in the Northern Territory, administered by the Work Health Authority); and correspondingly that the cost of work accidents and traditional workers' compensation insurance should be reduced.

All schemes substantially restrict the common law. For example, the Northern Territory and South Australia have abolished common law actions. In Victoria and Western Australia, the right to sue for general damages and for pecuniary loss is retained, but only for "serious" injuries. There is also a monetary threshold and a maximum award. New South Wales, which abolished common law rights of action against employers in 1987, restored the right to sue at common law on a limited basis.

FORMATION OF THE INSURANCE CONTRACT —

The proposal	¶17-075
Basis clause	¶17-090
Ambiguous questions in proposal forms	¶17-100
Blank or incomplete answers	¶17-110
State legislation	¶17-120
Cover notes	¶17-140
Concluded contract and the commencement of risk	¶17-200
Terms of the contract	¶17-201

¶17-075 The proposal. Whether insurance is arranged through an agent or broker, or by direct contact with an insurer, the formation of the contract usually starts with completion of a proposal form by the applicant for insurance.¹⁷ Insurer and applicant are to act in good faith at all times, and in this area the common law has been supplanted by the *Insurance Contracts Act*: “The evident intention of the legislature is to replace the antecedent common law regulating non-disclosure, misrepresentations and incorrect statements by insured persons before entry into a contract with the provisions of Part IV. To that extent Part IV is a statutory code which replaces the common law”¹⁸ (¶17-310ff). For where an insurance intermediary records incorrect information on the proposal form, see ¶17-550.

The purpose of the proposal form is to get from the applicant all information essential to the insurer’s assessment of the risk and the premium. The form will usually request information such as details of past losses and claims. Proposals for life or accident insurance will include questions on the applicant’s medical history. The life insurance industry and the federal government have jointly approved a voluntary code of practice relating to underwriting practices in so far as they concern HIV, which deals with matters such as the questions which may be asked in proposal forms, etc (eg medical history and sexual activities since 1980).¹⁹

A completed proposal is an offer by the applicant to enter into a contract of insurance. If the insurer rejects the proposal (offer) it must give the applicant (and in the case of life insurance the proposed life insured) written reasons for

17. The principles relating to the formation of contracts generally (Chapter 5) apply to insurance contracts. With regard to capacity to contract (¶5-520), sec 199 of the *Life Insurance Act 1995* (Cth) specifies that a “young person” aged 10 and over, but under 16, may take out a life policy with the consent of a parent; a minor aged 16 or over does not need any such consent. Insurance companies are also generally subject to the provisions of federal and State consumer protection (Chapter 7) and anti-discrimination legislation.

18. *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606 at p 615; ¶17-420.

19. The code of practice (released in 1988) stems from a 1987 report of a working group, chaired by Prof Marcia Neave, set up by the National Advisory Committee on AIDS. See CCH *Australian and New Zealand Life Insurance Reporter* ¶60-002.

its decision, if requested to do so, unless it would unreasonably put at risk the interests of itself or of someone else: *Insurance Contracts Act* sec 75.

If the insurer accepts the proposal (offer), its notification is the acceptance which makes a binding contract (unless there are any express provisions to the contrary in the proposal). The applicant's payment of the premium or the promise to pay is the consideration for the insurer's promise. Actual payment is not a condition precedent (§16-060) to the liability of the insurer, unless there is a specific term in the acceptance or the policy that there is no cover until the premium is paid.²⁰

If the insurer wishes to alter the terms of the proposal, its notification is a counter-offer (§15-300) which the applicant may accept or reject. In other words, insurance negotiations may create difficulties in determining exactly when the contract was concluded (see further §17-200).

The proposal, and the information contained in it, does not by itself form part of the contract of insurance; it must be expressly incorporated in the contract between insurer and insured, usually by appropriate language in the policy.

§17-090 Basis clause. Proposal forms may contain a "basis clause" specifying that the information provided is correct and that it forms the basis of the contract between insurer and insured. The basis clause may also appear in the policy itself.

If the proposal contains a basis clause and the proposal is incorporated in the policy (see §17-075), or if the policy itself specifies that the proposal is to be the basis of the contract, the information provided in the proposal becomes the foundation of the contract. Consequently, where the *Insurance Contracts Act* does not apply (see §17-035), any inaccuracy in that information, whether innocently made or trivial or immaterial to the risk, entitles the insurer to avoid the contract and thus not pay a claim.²¹

Basis clauses are now ineffective under the combined operation of a number of sections of the *Insurance Contracts Act*. For example, an untrue statement in a proposal (or made at any time in connection with a proposed contract of insurance) does not constitute a misrepresentation if the person making it reasonably believed it to be true (irrespective of the terms of the proposal or the policy) (sec 26(1)). Furthermore, such a statement is only a misrepresentation if the person making it knew, or a reasonable person in the circumstances could be expected to have known, that it was material to

20. *Goodwin v State Government Insurance Office (Queensland)* [1994] 2 Qd R 15 (Full Court, Qld).

21. *Condogianis v Guardian Assurance Co Ltd* [1921] 2 AC 125; (1921) 29 CLR 341; *Dawsons Ltd v Bonnin* [1922] 2 AC 413. Sections 83 and 84 of the *Life*

Insurance Act 1945 (Cth), which restrict an insurer's right to avoid a life policy for certain incorrect statements in a proposal (or other document) (§17-480), do not apply to life insurance contracts entered into after 1 January 1986. These sections are "saved" by the *Life Insurance Act 1995* (Cth) sec 264.

the insurer's assessment of the risk (sec 26(2)). In addition, an insurer's remedies for a misrepresentation are restricted (see ¶17-420).

¶17-100 Ambiguous questions in proposal forms. Section 23 of the *Insurance Contracts Act* clarifies the effect of ambiguous questions in relation to insurance — these most commonly occur in proposal forms. It provides that where a person answering an ambiguous question thinks that the question has a certain meaning, and a reasonable person in the circumstances would have understood the question to have had that meaning, the question will be taken to have that meaning.

¶17-110 Blank or incomplete answers. A clause in a proposal form stipulating that any unanswered questions are deemed to be answers in favour of the insurer is now ineffective where the *Insurance Contracts Act* applies. Section 27 provides that a person will not be taken to have made a misrepresentation solely because of failing to answer a question or giving an obviously incomplete or irrelevant answer to a question in a proposal form. Nor in such circumstances will the insurer be able to rely on a breach of the duty of disclosure (¶17-330), since the insurer will be deemed to have waived compliance with the duty (sec 21(3): ¶17-380).

¶17-120 State legislation. State legislation or other Commonwealth legislation applies to the few classes of insurance not covered by the *Insurance Contracts Act* (¶17-035) and is now of limited importance.

The State legislation provides that an insurer cannot avoid a policy for an incorrect statement in a proposal unless the statement is fraudulently untrue or material to the insurer in relation to the contract (sec 18A of the *Insurance Act 1902* (NSW) and sec 25 of the *Instruments Act 1958* (Vic)). Similarly, in most jurisdictions legislation dealing with third party motor vehicle insurance and workers' compensation insurance restricts an insurer's rights to avoid a policy or otherwise deny liability on the grounds of misrepresentation, non-disclosure, etc.

¶17-140 Cover notes. A person who requires immediate insurance cover, for example when buying a car, can get temporary (or interim) insurance in the form of a cover note, which can often be arranged over the phone. It gives the insured the benefit of cover while the insurers are assessing not only the proposed insurance risk but also the character and antecedents of the applicant. Cover notes are not usually issued in respect of life insurance.

A cover note is an "interim contract of insurance"²² recognised by the *Insurance Contracts Act* as a "policy document" (sec 11), which provides cover for a stated period, say 30 days.

22. For the purposes of the *Insurance Contracts Act*, an interim contract of insurance is a contract intended by the insurer to provide temporary cover and

to be replaced or superseded by another contract of insurance, whether or not the interim contract is evidenced by a cover note.

A cover note, although informal and interim, is as much a contract of insurance as is a formally issued policy. Accordingly, the normal contractual and insurance law principles (including the duty of disclosure: ¶17-330) apply. Authority to conclude a binding cover note will often be vested in the insurer's agent, particularly if the agent is entrusted with blank cover notes, or even a broker where there is a pre-existing arrangement. (The relevant agency principles are discussed at ¶17-500ff.)

Once the applicant's offer is accepted by the insurer, in the form of an acknowledgement (including over the telephone) that the applicant is covered for a stated period, there is a concluded contract. Documents subsequently sent to the applicant cannot, therefore, alter the terms of that contract.

A cover note will usually be expressly issued "subject to the terms and conditions of the company's policy". There is authority for the view that only those terms and conditions which, in the circumstances, may reasonably apply to the contract will be incorporated.²³

The following provisions of the *Insurance Contracts Act* do not apply in relation to interim contracts of insurance:

- sec 35 — payment of claims under contracts for which standard cover is prescribed (¶17-775);
- sec 37 — notification by insurer of unusual terms in a contract of insurance (for which standard cover is not prescribed) (¶17-610);
- sec 40 — notice by insured of facts that may give rise to a claim under liability insurance (¶17-760);
- sec 44 — average provisions (¶17-850);
- sec 68(1) — contracts affecting insurer's rights of subrogation (¶17-920).

A term to the effect that a cover note is issued subject to a "satisfactory proposal" from the applicant is rendered ineffective under sec 38(1) of the *Insurance Contracts Act*.

Cancellation of cover note. Section 60(4) of the *Insurance Contracts Act* gives an insurer the right to cancel a cover note, or other form of interim contract of general insurance, at any time. Where an insurer cancels a cover note, for whatever reason, it must give at least three days' written notice (sec 59).

Where the Act does not apply, the insurer may only cancel a cover note if given the right to do so. (If the cover is expressed to be subject to the terms of the insurer's policy, cancellation must be in accordance with the policy.)

¶17-200 Concluded contract and the commencement of risk. It is important for both insurer and insured²⁴ to be aware of exactly

23. eg *Car Owners' Mutual Insurance Co Ltd v Buckley* (1986) 4 ANZ Insurance Cases ¶60-693.

24. eg the applicant's duty to disclose all material facts ceases when the contract is concluded (see ¶17-340).

when the insurance contract is concluded and when the insurer is on risk. These two events need not coincide, though usually they do.

Often the premium is forwarded to the insurer with the proposal so that when the proposal is accepted there is a concluded contract and, depending on the terms of the contract, the insurer is on risk from that moment. The issue of a policy is not essential for the completion of the contract, unless otherwise agreed, eg in the proposal. A preliminary arrangement does not give rise to a contract of insurance.

In accordance with the law of contract, acceptance of an offer must be complete and unqualified (see ¶5-240). Where the applicant does not tender the premium with the proposal the insurer will, upon "acceptance" of the proposal, send notification of its acceptance and request payment of the premium. That amounts in fact to a counter-offer (¶5-300), so that the contract will be complete on tender²⁵ of the premium to the insurer; provided that there has been no change in the risk, the insurer cannot refuse the premium. (If there is a material change in the risk, tender of the premium would be regarded as a new offer for a new risk.) Similarly, if the proposal is accepted subject to conditions, that is also likely to represent a counter-offer. Acceptance of an offer is not usually effective until communicated to the applicant (see ¶5-310), unless the offer is unilateral (eg coupon accident insurance offered by some newspapers to their readers and coupon travel insurance offered at some overseas airports) or, under the terms of the contract, acceptance takes the form of the signing and sealing of a policy by the insurer.

¶17-201 Terms of the contract. For a binding contract to come into existence, the essential matters must be agreed upon, but otherwise the insured will be deemed, in the absence of express agreement to the contrary, to have agreed to the insurer's usual terms and conditions in respect of the type of insurance in question. Where standard cover under the *Insurance Contracts Act* is in force (as prescribed by the *Insurance Contracts Regulations*), then the particular terms prescribed by the Regulations will apply, irrespective of the terms of the insurer's policy (see ¶17-610). Section 53 of the Act also prohibits an insurer from varying the terms of the contract to the prejudice of anyone other than the insurer.

If an insurer offers cover on less advantageous terms than it otherwise would, because of some special risk, the applicant (and, in the case of life insurance, the proposed life insured) can require the insurer to give written reasons for its decision: *Insurance Contracts Act* sec 75 (see ¶17-075).

25. If the premium is in fact posted, the contract should be completed upon posting: *Household Fire and Carriage Accident Insurance Co Ltd v Grant* (1879) 4 Ex D 216, noted at ¶5-330. If the policy recites that the insured has paid or has

agreed to pay the premium, payment of the premium is not a condition precedent to recovery: *Evans v Sirius Insurance Co Ltd* (1986) 4 ANZ Insurance Cases ¶60-755.

BASIC CONCEPTS UNDERLYING INSURANCE LAW: I. INSURABLE INTEREST

The requirement of insurable interest:

introduction	¶17-205
Insurable interest: indemnity or general insurance	¶17-210
Insurable interest: contingency or life insurance	¶17-220
Extent of interest	¶17-230

¶17-205 The requirement of insurable interest: introduction. At common law, an insurable interest is required, in the case of general insurance, at both the time of making the contract and the time of loss, and in the case of life insurance, at the time of making the contract. In marine insurance an insurable interest need only exist at the time of the loss.²⁶

This requirement was introduced by the *Imperial Life Assurance Act 1774*²⁷ and was also reflected in gaming and wagering legislation which required the person making the wager to have an interest in the subject matter of the wager (if no interest exists when the contract is made it will be a wager unless there is at least a genuine expectation of acquiring an interest). That Act (or equivalent local provisions: ¶17-220) remained in force in most of Australia until its repeal by sec 3 of the *Insurance Contracts Act 1984* (Cth) (so far as it was part of Commonwealth law) in relation to contracts or proposed contracts of insurance to which the *Insurance Contracts Act* applies (¶17-035).²⁸

¶17-210 Insurable interest: indemnity or general insurance. Before the *Insurance Contracts Act 1984* (Cth) was passed, there were many technical rules defining the classes of insurable interest necessary to support an insurance policy. At common law, a mere hope or expectation would not support an insurable interest, but a possessory, contingent or equitable interest (¶3-210ff) would.²⁹ The following case shows a strict example of insurable interest at common law.

— Case example —

Insurable interest at common law. The insured (P) owned a timber plantation, and had insured the timber in his own name with insurer D. P assigned the timber to a company in which he owned most of the shares, and the company owed him money for the timber. The insurance on the timber remained in P's

26. *Marine Insurance Act 1909* (Cth) sec 12.

27. The requirement of insurable interest was first introduced in marine insurance by the *Marine Insurance Act 1745* (Imp).

28. The *Life Assurance Act 1774* (Imp) remains in force in so far as it forms part of the law of South Australia, Western Australia, Tasmania, the Australian

Capital Territory and the Northern Territory. Section 3 of the *Insurance Contracts Act* repeals the *Marine Insurance Act 1788* (Imp) to the same extent.

29. *Truran Earthmovers Pty Ltd v Norwich Union Fire Insurance Society Ltd* (1976) 17 SASR 1 at p 8.

own name. When the timber was destroyed by fire, D refused to pay P's claim on the basis that P had no insurable interest in the assets owned by the company. P's claim failed. P could not insure property of the company as:

- an unsecured creditor of the company (at common law no person can insure the property of a debtor);
- a shareholder. A shareholder does not own property owned by the company, is not responsible for its safety and does not have any legal or equitable interest in company property.

_____ *Macaura v Northern Assurance Company Ltd*³⁰ —

The *Insurance Contracts Act* has changed all this. A contract of general insurance to which the Act applies (see ¶17-035) is no longer void by reason only that the insured did not have an interest in the subject matter of the contract at the time it was entered into (sec 16(1)). This does not apply to contracts providing for payment on the death of a person by accident or sickness.

In addition, the indemnity principle (¶17-260) has been restated in economic terms (the ALRC felt this would make little difference since recovery was dictated by the indemnity principle and the occurrence of loss).

Section 17 provides that:

“Legal or equitable interest not required at time of loss

17 Where the insured under a contract of general insurance has suffered a pecuniary or economic loss by reason that property the subject-matter of the contract has been damaged or destroyed, the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the insured did not have an interest at law or in equity in the property.”

The categories of person capable of having an insurable interest recognised by the common law are therefore no longer relevant where the Act applies (¶17-035). Someone in Macaura's position would now be entitled to recover. Nor is an insurer under either a life or general contract of insurance relieved of liability, just because the names of those who may benefit under the contract are not set out in the policy document (as required by sec 2 of the *Life Assurance Act 1774* (Imp) and equivalent State legislation) (sec 20).

¶17-220 Insurable interest: contingency or life insurance.

As with policies of general insurance, a policy of life insurance to which the *Insurance Contracts Act 1984* (Cth) applies does not require an insurable interest. Under the Act, a contract of life insurance or a contract providing for the payment of money on the death of a person by sickness or by accident is not void by reason only that, at the time of making the contract, the insured did not have an insurable interest in the life of the life insured (*Insurance Contracts Act* sec 18).

30. [1925] AC 619.

At common law and under certain State enactments³¹ life insurance contracts without an insurable interest are void. For example, the de facto spouse and dependant of an insured has an insurable interest in the life of his or her de facto partner.³²

¶17-230 Extent of interest. The principle of insurable interest is closely related to the principle of indemnity (¶17-260). In the case of general insurance, an insured cannot generally recover more than the amount of the loss occurring (see ¶17-260), which in most cases will be the value of the insured's interest (usually specified in the contract) whether or not an insurable interest is required (see ¶17-210).³³

Although an insured with a limited interest can insure the subject matter of the insurance for its full value, there is a rebuttable presumption (of fact) of intention to protect only the insured's own interest. At common law an insured with a limited interest can recover more than the value of the insured's interest if, on a true construction of the contract, it was intended also to insure the interests of others.³⁴

Insurance of real property can also be construed so as to insure interests other than the insured. In practice, this is more likely to occur in the cases of trustee and beneficiary (where there is really only one interest involved) and mortgagee and mortgagor than in the cases of vendor and purchaser³⁵ and landlord and tenant.

31. *Instruments Act 1958* (Vic) sec 21-24; *Imperial Acts Application Act 1969* (NSW) sec 23; *Imperial Acts Application Act 1984* (Qld) sec 8.

32. *Herbon v NZI Life Ltd* (1999) 10 ANZ Insurance Cases ¶61-410. This case was brought under the now-repealed sec 19 of the *Insurance Contracts Act*, which required an insurable interest for life insurance.

33. *Insurance Contracts Act 1984* (Cth) sec 17. In the case of general insurance not covered by the Act, see *Imperial Acts Application Act 1969* (NSW) sec 23(3); *Instruments Act 1958* (Vic) sec 23 and *Imperial Acts Application Act 1984* (Qld) sec 8(3). Computation of loss is considered in more detail at ¶17-830.

34. *Davjoyda Estates Pty Ltd v National Insurance Co of New Zealand Ltd* (1965) 69 SR (NSW) 381 at pp 422-423.

35. Sec 50 of the *Insurance Contracts Act* provides that, where the risk has passed to the purchaser of a building, the

purchaser will be deemed to be an insured under any contract of insurance effected by the vendor in respect of the building and such of its contents as are being sold or assigned to the purchaser, until the earlier of completion, the purchaser taking possession or effecting his own insurance, or the termination of the sale. Section 50 overrides, in respect of contracts covered by the Act, the common law position as exemplified in *Castellain v Preston* (1883) 11 QBD 380; [1881-85] All ER Rep 493; *Ziel Nominees Pty Ltd v VACC Insurance Co Ltd* (1975) 180 CLR 173: ALRC, *Insurance Contracts* (1982), *op cit*, para 132. In NSW the risk now passes on completion and not on exchange of contracts, unless the parties agree that it should pass when the purchaser enters into or is entitled to enter into possession: *Conveyancing Act 1919* sec 66K. See also *Sale of Land Act 1962* (Vic) sec 35 and *Property Law Act 1974* (Qld) sec 63, which allow the purchaser to benefit under the vendor's insurance.

Under the *Insurance Contracts Act*, where the sum insured exceeds the value of the insured's interest, any person other than the insured who has an interest in the insured property such as a mortgagee or a lessor (eg of a motor vehicle)³⁶ is entitled to receive from the insurer the difference between the amount for which the insurer would be liable if the insured were the only person with an interest in the property (in effect, the sum insured less any deduction under an average provision, if any (¶17-850)) and the amount of the insured's loss (sec 49). Such recovery is not possible where the contract covers only the insured's interest and the insured has been informed of this in writing.

In addition, sec 48(1) of the Act provides for recovery by a third person (C) who is not a party to a contract of general insurance between insurer A and insured B but who is specified or referred to in the policy as the person to whom the cover extends.³⁷ Section 48(3) says that insurer A has the same defences to a claim by C under the A/B policy as it would have against B, yet case law conflicts on whether non-disclosure by insured B limits the rights of third person C who was not involved in B's non-disclosure.³⁸

BASIC CONCEPTS UNDERLYING INSURANCE

LAW: II. INDEMNITY

The principle of indemnity	¶17-260
Double recovery	¶17-270
Valued policies	¶17-290
Life insurance — an exception to the indemnity principle	¶17-300

¶17-260 The principle of indemnity. The main purpose of indemnity insurance is to give the insured financial protection by providing indemnity against the consequences of possible risks. Therefore:

- (1) The insured must have an economic interest in the subject matter of the insurance, otherwise the insured can suffer no loss by its damage

36. Courtenay, DP, *The innocent mortgagee: insurance without cost* (1989) 63 ALJ 537.

37. As confirmed in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107; (1988) 5 ANZ Insurance Cases ¶60-873. (In this case the contract preceded the commencement of the *Insurance Contracts Act 1984* (Cth), so sec 48 could not apply.) Mason CJ, Wilson and Toohey JJ said that insurance, in particular liability insurance, provided an exception to the privity of contract

rule; Gaudron J based her decision on the concept of unjust enrichment (see further ¶6-260—¶6-270). See further Fotheringham, M, *The insurance contract — time for reform of section 48* (2000) 11 ILJ 127.

38. C cannot claim: eg *Commonwealth Bank of Australia v Baltica General Insurance Co Ltd* (1992) 7 ANZ Insurance Cases ¶61-133; discussed at (1993) 21 ABLR 155.

or destruction. (This connects with the requirement in sec 17 that the insured must have suffered a “pecuniary or economic loss”: ¶17-210.)

- (2) The value of that interest determines the amount of the indemnity recoverable (see ¶17-230). That value is normally the market value, especially where there is an available market for the interest destroyed. In particular, the insured is not entitled to profit from the loss.
- (3) A contract which contemplates the possibility of the insured making a profit out of the realisation of the contingency is a wager and contrary to the true nature of insurance.

A claim for indemnity is the equivalent of a claim for unliquidated damages, even if the policy is a “valued policy” (¶17-290), subject to any maximum limit specified in the contract, and the principle of average (¶17-850). The amount of the loss is generally worked out by reference to the value of the insured property at the date and place of the loss, although the terms of the policy may provide otherwise (see ¶17-830). Indemnity is usually provided by payment by cheque, although the policy may give the insurer the option to repair, reinstate or replace damaged or destroyed property. Reinstatement is discussed at ¶17-840.

Indemnity is subject to the following rules:

- (1) Maximum cover. Section 42 provides that the insured can recover the maximum cover for the premium paid. For example, if the insured only insures goods for \$5,000 for a premium of, say, \$80, and the insurer charges a minimum premium of \$80 for payment of \$6,000 or less, the insured will be able to recover up to \$6,000.
- (2) The principle that the insured cannot recover more than the insured’s loss remains unchanged. Indeed, where persons other than the insured have an interest in the subject matter of the insurance (see ¶17-230), sec 49(5) specifically provides that neither such persons nor the insured will be entitled to recover more than the amount of their loss.³⁹
- (3) Over-insurance. The insured cannot recover more than the loss, otherwise the insured would make a profit on the loss.
- (4) Under-insurance. A claim may be reduced in proportion to the amount of the under-insurance under the principle of average: ¶17-850.
- (5) Double insurance. An insured cannot profit from the loss, so the law restricts both double recovery (¶17-270) and double insurance (¶17-900).
- (6) Some policies are valued policies (¶17-290).

39. See also sec 67(2) in relation to moneys recovered by an insurer in exercising a right of subrogation (¶17-920) and sec

76(2) in relation to contribution where two or more insurers are liable under separate contracts (¶17-910).

¶17-270 Double recovery. Under the indemnity principle, the insured cannot benefit from the insured's loss. If the insured recovers in full from the insurer and also obtains damages from a third party whose action caused the loss, the insured must reimburse the insurer⁴⁰ (one aspect of the doctrine of subrogation: ¶17-920).

Another example of the insured's not being able to profit from the loss is in the case of sale of real estate which is damaged or destroyed before settlement. If the vendor recovers from the insurer, and the purchaser subsequently completes the purchase, the vendor must reimburse the insurer (¶17-230).

Double recovery is also not allowed where the insured has taken out two or more policies in respect of the same risk ("double insurance"). Although the insured can choose from which insurer to claim, the insured cannot recover in total more than the loss. Thus the insured will only be able to claim from another insurer where the first insurer does not provide a full indemnity (¶17-900). Where the one insurer does provide a full indemnity it may be entitled to seek a contribution from the other insurers (see ¶17-910).

¶17-290 Valued policies. The indemnity principle — a claim for unliquidated damages (¶17-260) — applies equally to a "valued policy". Under a valued policy, the parties to an insurance contract can agree (in advance) upon the value of the insured property in the event of a loss. This can include a "new for old" policy. In such a case the insured is entitled to the agreed value, or proportion thereof if the loss is partial (see ¶17-830), regardless of the actual value of the property at the date of loss.⁴¹

¶17-300 Life insurance — an exception to the indemnity principle. Contracts of contingency or life insurance and personal accident insurance are exceptions to the indemnity principle (see ¶17-040). The amount recoverable upon maturity of the policy is not usually measured by reference to the insured's loss:

- (1) The legal system has traditionally not accepted the possibility of placing a value upon human life.
- (2) In many instances the insured is also the subject matter of the insurance, so that the loss caused by the insured's death is to the estate.
- (3) Some life policies are designed for investment with the provision of death cover being only secondary.
- (4) The sum payable upon the death of the life insured is agreed when the insurance is effected.

40. Likewise, the insurer cannot avoid liability on the ground that the insured has a right to claim against a third party, and the third party cannot avoid liability

on the ground that the insured has been or will be fully indemnified by the insurer.

41. *British Traders Insurance Co Ltd v Monson* (1964) 111 CLR 86 at p 93.

BASIC CONCEPTS UNDERLYING INSURANCE LAW: III. GOOD FAITH/DISCLOSURE

Principle of good faith	¶17-310
Duty of disclosure	¶17-330
Duration of duty of disclosure	¶17-340
Knowledge of insured	¶17-350
Knowledge of insurer	¶17-360
Waiver — insurer put on inquiry	¶17-370
Waiver — questions in the proposal	¶17-380
Materiality — the test	¶17-390
Examples of material facts	¶17-400
Onus of proof	¶17-410
Effect of non-disclosure	¶17-420

¶17-310 Principle of good faith. Insurance contracts, unlike ordinary contracts for the sale of goods or for the provision of services, are contracts *uberrimae fidei*, ie each party is under a duty to exercise the utmost good faith towards the other in respect of any matter arising under or in relation to the contract. That duty, which was recognised at common law, is made an implied term of insurance contracts by sec 13 of the *Insurance Contracts Act*. Remedies under the Act for breach of contract⁴² are available for enforcement of the duty of good faith.

Good faith “encompasses notions of fairness, reasonableness and community standards of decency and fair dealing.”⁴³ It involves an “element of honesty”.⁴⁴

The duty of good faith is well recognised in connection with the duty of disclosure (¶17-330). Its application to dealings under insurance contracts by insurers as well as by insureds (for example, in making and settling claims: ¶17-700) has been supported by judicial statements.⁴⁵ That is confirmed by sec 13 and reinforced by sec 14, which provides that both insurer and insured are not to rely on any provision of the insurance contract if to do so would be to fail to act with the utmost good faith.⁴⁶

42. Such as that under sec 54 (¶17-650, ¶17-710).

43. Sutton, KCT, *Insurance Law in Australia*, LBC, 3rd ed, 1999, para 3.7, the 2nd ed of which was cited in *Kelly v New Zealand Insurance Company Ltd* (1996) 9 ANZ Insurance Cases ¶61-317 at p 76,519.

44. *CIC Insurance Ltd v Barwon Region Water Authority* (1999) 10 ANZ Insurance Cases ¶61-425 at p 74,774.

45. See, eg, Stephen J in *Distillers Company Bio-Chemicals (Aust) Pty Ltd v Ajax Insurance Co Ltd* (1974) 130 CLR 1, noted at (1975) 49 ALJ 31; *Re Zurich Australian Insurance Ltd* (1999) 10 ANZ Insurance Cases ¶61-429 at pp 74,833-74,839.

46. eg Bremen, J, *Good faith and insurance contracts — obligations on insurers* (1999) 19 Aust Bar Rev 89.

— *Case example* —

A thoroughbred colt was insured against loss (defined in the policy to mean accidental death, disease or destruction for humane reasons). On veterinary advice, but without the insurer's consent, the owner had the colt destroyed for humane reasons. The insurer denied liability as it had refused its consent to the colt's destruction because, according to its own veterinary advice, the colt's condition could improve with treatment. Indeed, the insurer had offered to pay the veterinary fees for the treatment. The owner claimed that the insurer's refusal of consent to destruction was a breach of the policy and of its obligation to act towards the insured with the utmost good faith under sec 13 and 14. Equally, the insurer claimed that the insured's conduct in having the colt destroyed was in breach of its good faith obligations to the insurer under sec 13 and 14. This contest of good faith was ultimately resolved in favour of the insured with the assistance of an arbitrator's report. The owner was entitled to judgment for \$500,000.

*Hobartville Stud Pty Ltd v Union Insurance Co Ltd*⁴⁷ —

Insurance, the Trade Practices Act and the ASIC Act. Insurers and insurance agents and brokers may be liable to their clients under the *Trade Practices Act 1974* (Cth), which applies to some aspects of insurance. Sections 51AAB and 51AF of the *Trade Practices Act* state that the Act does *not* apply to “financial services” — a “financial service” is defined in the ASIC Act sec 12BA (¶7-240) to mean a “financial product”, which is defined to mean (amongst others) “a contract of insurance” including a life policy or a sinking fund policy. An insurance problem that does not involve a “contract of insurance”, would be covered by the *Trade Practices Act*.

Many sections in Part V of the *Trade Practices Act* dealing with consumer protection are paralleled in the *Australian Securities and Investments Commission Act 1989* (Cth), which applies to a “financial service”, which means a service that provides or is supplied in relation to a “financial product” meaning (amongst others) a “contract of insurance” (sec 12BA).

The ASIC Act does not apply to non-“financial product” situations, and the *Trade Practices Act* would apply to the following as they are not a “contract of insurance”:

- an applicant during pre-contractual negotiations before the making of a contract of insurance;
- an insured's conduct during the performance of a contract of insurance;
- an insured's conduct during unsuccessful negotiations that do not result in a concluded contract of insurance; or
- an agent or broker during negotiations or other non-contractual discussions with an insurer.⁴⁸

47. (1991) 25 NSWLR 358; (1991) 6 ANZ Insurance Cases ¶61-032.

48. eg van den Dungen, P, *Good faith, unconscionable conduct and imaginary*

community standards — section 51AC of the *Trade Practices Act* and the *insurance industry* (1998) 10 ILJ 1.

Hence the following conduct may be litigated under the *Trade Practices Act* (if it is not a “financial product”), the ASIC Act (if it is a “financial product”) or both (depending on an analysis of the conduct in question):

- misleading or deceptive conduct (sec 52: ¶7-250ff; ASIC Act sec 12DA);
- other “unfair practices”:
 - false representations (TPA sec 53; ASIC Act sec 12DB; ¶7-290ff);
 - false representations relating to land (TPA sec 53A; ASIC Act sec 12DC: ¶7-380);
 - not stating the cash price (TPA sec 53C; ASIC Act sec 12DD: ¶7-395);
 - offering gifts and prizes (TPA sec 53; ASIC Act sec 12DE: ¶7-400);
 - misleading conduct regarding financial services (TPA sec 55A; ASIC Act sec 12DF: ¶7-415);
 - bait advertising (TPA sec 56; ASIC Act sec 12DG: ¶7-420);
 - referral selling (TPA sec 57; ASIC Act sec 12DH: ¶7-430);
 - accepting payment without intending to supply as ordered (TPA sec 58; ASIC Act sec 12DI: ¶7-440);
 - harassment and coercion (TPA sec 60; ASIC Act sec 12DJ: ¶7-460);
 - pyramid selling (TPA sec 61; ASIC Act sec 12DK: ¶7-470);
 - inertia selling: unsolicited credit cards and debit cards (TPA sec 63A; ASIC Act sec 12DL: ¶7-490); and
 - inertia selling: assertion of right to payment for unsolicited services (TPA sec 64; ASIC Act sec 12DM: ¶7-490);
- breach of warranties in relation to services (TPA sec 74; ASIC Act sec 12ED: ¶7-095).

Equally, an insurer may be liable to an agent or broker under these sections.

Many of the remedies in the *Trade Practices Act* (Part VI — sec 75B-87C: ¶8-750ff) are paralleled in the ASIC Act (sec 12GA-12GO).

Insurance and unconscionability. The unconscionability provisions in the *Trade Practices Act* Part IVA, paralleled in the ASIC Act sec 12CA and 12CB, now add to the insurer’s existing duty of good faith.

Although sec 15 of the *Insurance Contracts Act* excludes unconscionability legislation from insurance contract disputes, sec 15 does not apply to unconscionable pre-contractual and non-contractual conduct of the insurer.⁴⁹ As discussed above, both the *Trade Practices Act* and the ASIC Act apply to

49. At the time sec 15 was enacted, unconscionability was prohibited only under the *Contracts Review Act 1980* (NSW), so the purpose of sec 15 was

partly to avoid potential Commonwealth and State/Territory jurisdictional disputes.

insurance in certain situations depending on whether or not there is a “financial product”.

If there is a “financial product” (meaning a contract of insurance), unconscionable conduct is regulated by the ASIC Act sec 12CA, 12CB. If there is no “financial product” and no contract of insurance (such as pre-contract negotiations), unconscionable conduct is regulated by the TPA Part IVA: ¶5-755.

This means that unconscionability legislation in:

- the TPA sec 51AA and the ASIC Act sec 12CA (which incorporate current case law), and
- the TPA sec 51AB paralleled in the ASIC Act sec 12CB (¶5-755)

can provide remedies under the *Trade Practices Act* (paralleled in the ASIC Act: ¶5-755) to anyone who suffers loss or damage because of unconscionable conduct by an insurer.

Business transactions involving the supply or acquisition of goods or services under sec 51AC (¶5-756) are not paralleled in the ASIC Act.

The unconscionability provisions in the TPA sec 51AB and the ASIC Act sec 12CB (¶5-755) may help to interpret an insurer’s duty of the utmost good faith. For example,

- what were the relative bargaining positions of insurer and insured?
- was there anything unconscionable in the insurer’s conditions and the fine print? The insurer is required to notify the insured of contract provisions under the *Insurance Contracts Act* sec 14(3), but was the insured able to understand them as required by the TPA sec 51AA, 51AB or 51AC or by the ASIC Act sec 12CA or 12CB?

Extra tests are imposed on insurers in the case of business v business unconscionability (sec 51AC: ¶5-756, with no ASIC Act parallel), such as:

- the insurer’s track record in dealings involving similar transactions (sec 51AC(3)(f)); and
- the insurer’s willingness to negotiate with an applicant and whether the applicant was left uninsured (sec 51AC(3)(j)).

The Australian Securities and Investments Commission (ASIC: ¶9-380; ¶17-035) is responsible for the general administration of the *Insurance Contracts Act 1984*.

¶17-330 Duty of disclosure. The most important consequence of the *uberrimae fidei* principle (see ¶17-310) is the doctrine of disclosure: during the negotiations for a contract of insurance both parties are under a duty to disclose, on their own initiative, all facts of which they are aware and which are material to the proposed insurance.

The common law duty of disclosure (which is not a term of the contract) was developed at an early stage (in the classic judgment of Lord *Mansfield*

in *Carter v Boehm*¹). Nearly all the decided cases concern alleged breaches of the duty by the insured. However, a major English House of Lords decision from 1990 reminds insurers that the common law duty of disclosure applies equally to them. Hence an insurer is to disclose its knowledge that a ship to be insured for a voyage has already arrived or that a house to be insured against fire has been demolished. But, as held in this case, the insurer is not under a duty to disclose (to the insured) its knowledge that its agent has been dishonest if the dishonesty was not material to the recoverability of a claim under the policy.²

The duty of disclosure on the part of the insured (but not the insurer) has been legislated as sec 21 of the *Insurance Contracts Act*. The major reform concerns the test of materiality (see ¶17-390). The duty is not rendered more onerous by the operation of sec 13 (duty of utmost good faith: ¶17-310). Where the Act does not apply, the common law duty, which applies to all types of insurance, will continue to have effect.

Disclosure in "eligible contracts of insurance". Under sec 21A, added in 1998, the insurer must identify the information it needs to assess the risk by asking specific questions that are relevant to its decision to insure. If the insurer does not get all the information it needs from these questions, it is deemed to have waived compliance with the insured's duty of disclosure.

The insurer can request the insured to answer specific questions regarding the risk (sec 21A(3)). Alternatively, the insurer can expressly request the insured to disclose each "exceptional circumstance" known to the insured which the insured knows or would be expected to know is a "matter relevant" to the insurer (sec 21A(4)).

"Eligible contracts of insurance" are specified by regulation (reg 2B). A contract of general insurance is an "eligible contract" if it is for new business and is in a class of contracts dealing with motor vehicles, home buildings and contents, sickness and accident, consumer credit and travel insurance.³

Insurer to inform insured of duty of disclosure. The duty of disclosure is so important to insurance that sec 22 requires the insurer to inform the insured, in a written disclosure statement, of the "general nature and effect" of the duty of disclosure under sec 21 or sec 21A before a contract of insurance is

1. (1766) 3 Burr 1905; 97 ER 1162; [1558-1774] All ER Rep 183. See also Latimer, P, *Extra-contract recovery in insurance law* (1980) 3 UNSWLJ 381.

2. *Banque Financière de la Cité SA (formerly Banque Keyser Ullman SA) v Skandia (UK) Insurance Co Ltd* [1990] 3 WLR 364; (1990) 6 ANZ Insurance Cases ¶60-987, noted (1990) 64 ALJ 740, ¶17-420 (leading underwriter did not need to disclose to insured banks — under credit insurance policies taken out as security for loans — the deceit of the

broker who arranged the insurance on behalf of the banks (the broker had said that the insurance was fully subscribed when it was not — knowing that the banks would not have advanced the loans had they been aware of the true position) because the deceit was not material to the risk). At common law, breach of duty of disclosure does not give rise to damages — the remedy is to rescind the policy and recover the premium.

3. Noted, eg, (1999) 27 ABLR 518 (Sutton).

entered into.⁴ Failure to so inform the insured means that the insurer loses its rights in the event of non-disclosure, such as the right to reduce its liability to nil under sec 28(3) in the event of non-disclosure (¶17-420).⁵

Special disclosure rules for consumer credit insurance were introduced in 1994 (¶17-050).

¶17-340 Duration of duty of disclosure. Under sec 21 of the *Insurance Contracts Act* — and at common law — the duty to disclose all relevant material facts continues only until the contract of insurance is entered into (which includes renewed, varied, extended or reinstated, as appropriate: sec 11(9)). Thus any new relevant fact which arises after completion of the proposal, but before its acceptance, must be disclosed.

If the applicant has made a mistake in the proposal, or a change of circumstances makes a previously correct statement incorrect, the applicant must disclose this if relevant. The duty of disclosure only stops when the policy is concluded. There may be an express term in the policy that the insured must disclose facts occurring during the insurance which materially increase the risk. In addition, sec 13 and 14 impose a statutory requirement of good faith (¶17-310), and there may be an implied term in the policy that the parties will act in the utmost good faith.⁶

However, failure to disclose an increase in the risk may be of limited effect or of no effect under sec 54 of the *Insurance Contracts Act* (¶17-640).

The duty also applies to the renewal of a contract, both at common law and under the *Insurance Contracts Act* sec 11(9). Therefore all material facts arising between the date of the original contract and the date of renewal should be disclosed before renewal.

¶17-350 Knowledge of insured. The duty of disclosure, both at common law and under sec 21 of the *Insurance Contracts Act*, extends only to facts known to the applicant:⁷ “You cannot disclose what you do not know.”⁸ There is generally no duty to disclose mere opinions, rumours or suspicions, although in one case⁹ it was held that the insured should have disclosed his

4. Forms of notice are prescribed by the *Insurance Contracts Regulations 1985* (Cth) reg 3 with a paragraph headed “Your duty of disclosure” and a second paragraph headed “Non-disclosure”.

5. As in *Suncorp General Insurance Ltd v Cheihk* (1999) 10 ANZ Insurance Cases ¶161-442; ¶17-350.

6. eg *GIO Insurance Ltd v Leighton Contractors Pty Ltd* (1996) 9 ANZ Insurance Cases ¶161-293.

7. Where the applicant is a company or other commercial entity, it is the knowledge of those controlling the

company, etc which has to be considered; material facts in relation to those in control, as well as to the company, etc, must also be disclosed: *Marene Knitting Mills Pty Ltd v Greater Pacific General Insurance Ltd* [1976] 2 Lloyd’s Rep 631; 11 ALR 167; noted (1977) 3 Mon LR 322.

8. *Joel v Law Union and Crown Insurance Co* [1908] 2 KB 863, per *Fletcher Moulton* LJ at p 884.

9. *Khoury v GIO of NSW* (1983-1984) 165 CLR 622; (1984) 3 ANZ Insurance Cases ¶160-581 noted (1985) 59 ALJ 235.

belief that members of his household had stolen money from him, even if that belief was later shown to be wrong. A fact to be disclosed under sec 21 includes facts known by the proponent personally, as well as a fact known to the proponent's agent which can be imputed for the purpose of sec 21(1).

— *Case examples* —

“*Swingers*”. Inspection of Offices 1 and 2 after a fire indicated that the offices were not used by the tenant carpenter as an office, but were used as a brothel. Evidence indicated that the owner and the owner's real estate agent (who arranged the insurance) knew this, but that this information was not passed to the insurance broker who arranged the fire insurance or to the insurer. This fact was “known ... [by the insured] to be a matter relevant” to the insurer within sec 21 and it was not disclosed. Had the insurer known, it would not have insured the offices. The effect of this non-disclosure was to entitle the insurer to reduce its liability on the claim to nil under sec 28(3): ¶17-420.

— *Lindsay v CIC Insurance Limited*¹⁰ —

When P claimed for the theft of his Porsche coupe (insured for \$168,000), P's motor vehicle insurer was unsuccessful in denying liability on the basis that P had fraudulently failed to disclose important information. The court found P to be a “witness of truth”. In addition, because the insurer had failed in its obligation under sec 22 to inform P of his duty of disclosure (¶17-330), the insurer was not able to exercise its rights for any alleged non-disclosure by P under sec 21.

— *Suncorp General Insurance Ltd v Cheihk*¹¹ —

P issued a public liability policy to a company operating a backpackers hostel without knowing the identity of the owner of the building. There was no evidence of non-disclosure of the owner's identity by the insured under sec 21(2)(b) and the insurer was unable to reject the claim.

— *Commercial Union Assurance Company of Australia Ltd v Beard*¹² —

There is no duty to disclose matters of common knowledge (sec 21(2)(b)).

¶17-360 Knowledge of insurer. The insured is not required to disclose any matter which the insurer knows or in the ordinary course of its business as an insurer ought to know (sec 21(2)(c)). This will include matters disclosed before the contract was originally entered into (with the same insurer).

— *Case examples* —

The first reported case under the Insurance Contracts Act

In December 1985 P acquired a semi-trailer and set up business as a trucking contractor. To insure the vehicle, P approached insurance broker BW, dealing

10. (1989) 16 NSWLR 673; (1989) 5 ANZ Insurance Cases ¶60-913.

11. (1999) 10 ANZ Insurance Cases ¶61-442; ¶17-680. The insurer alleged that P had fraudulently failed to disclose details of his poor driving record, or that P had

failed to disclose that he had been convicted of driving while unqualified and had had his licence cancelled for six months.

12. (2000) 11 ANZ Insurance Cases ¶61-458; ¶17-360.

with its manager S. Together S and P went to the premises of insurer D and dealt with its employee L to fill in a proposal form and a funding form for payment by instalment. The policy was issued within a few weeks. The semi-trailer was off the road for repairs in January and February and because P paid no instalments for those months, D cancelled the policy in March. When the vehicle was repaired, D (through the same S and L) issued a new policy in April following a new proposal. In May P bought a second semi-trailer. Again he insured it, dealing with S (for the broker) and L (for D). P arranged with his bank to pay the instalments, but for the first instalment P made out a cheque which was later dishonoured. Fifteen days after P was notified by his bank that this cheque had been dishonoured, P's second vehicle was damaged in an accident. Insurer D denied liability, alleging that the second policy was null and void because of:

- (1) non-payment of premium. Rejected: the words in the policy reading "Whereas the Insured has paid or agreed to pay to the Company the sum stated" meant that payment of the premium was not a condition precedent to recovery (see further ¶17-200).
- (2) non-disclosure of the cancellation of the earlier policy on the first semi-trailer. Rejected under sec 21(2)(c): by P's dealing with the same personnel, the insurer D knew of the cancellation and P was not required to disclose it.

Although not necessary for the decision, the judge also noted that the earlier cancellation was not material—

- (a) if a trucking contractor's financial stability was relevant to the insurance, questions on that subject would be included in the proposal;
- (b) the terms of the second policy were not changed or "toughened" to reflect any higher risk of P;
- (c) the premium of the second policy was also not loaded and was in fact less than that of the first policy;
- (d) P's payment of premium by instalments would indicate that his financial position was not strong, yet no queries were raised by D.

The judge also said that even if there had been non-disclosure, he would have exercised the court's power to disregard avoidance under sec 31 (¶17-420) because "it would have been harsh or unfair to now penalise [P] by permitting [D] to avoid its liability in respect of the present claim when, in my opinion, any prejudice to [D] in respects of the loss ... by reason of [P's] non-disclosure has been insignificant" (p 74,556).

— *Evans v Sirius Insurance Co Ltd*¹³ —

A copy of a newspaper article in the insurer's files listing X as owner of the insured property is not evidence that the insurer "knows" this fact within sec 21(2)(c).

— *Commercial Union Assurance Company of Australia Ltd v Beard*¹⁴ —

"*PS Lady of Barmah*". P's paddlesteamer was under repair for an extended period on a slipway on the banks of the Murray River. The insurer, through

13. (1986) 4 ANZ Insurance Cases ¶60-755.

14. [1999] NSWCA 422; (2000) 11 ANZ Insurance Cases ¶61-458; ¶17-350.

its local broker, knew that the boat was slipped and it was taken to know that the risks of a boat on a slipway are different from the risks of a boat in the water. Hence the insurer could not deny P's claim on its public liability policy on the grounds of non-disclosure by P because this was something the insurer knew or ought to have known within the test in sec 21(2)(c).

*Carling v CGU Insurance*¹⁵ —

¶17-370 Waiver — insurer put on inquiry. An applicant need not disclose every material fact in minute detail. Both at common law and under the *Insurance Contracts Act* (sec 21(2)(d)), disclosure is not required where compliance with the duty is waived by the insurer. The duty will be satisfied if the applicant gives enough information to reasonably put the insurer on inquiry. If the insurer does not pursue the matter, it will be deemed to have waived disclosure of the facts which an inquiry would necessarily have revealed. In particular, sec 21(3) of the *Insurance Contracts Act* provides that an insurer will be deemed to have waived compliance with the duty if, in response to a question in a proposal form, the insured failed to answer the question or gave an obviously incomplete or irrelevant answer to it (¶17-110).

How much should the applicant reveal? Full disclosure involves not merely the statement of the bald fact of an accident, but some detail of the circumstances in which it occurred. So, for example, the High Court said that the answers “known to company” and “see Pol 2016/7” in a proposal for the renewal of a policy merely drew the insurer’s attention to the proposal completed prior to the issue of the policy and not to the insurer’s file, and thus was insufficient disclosure of traffic convictions since the date of the policy.¹⁶

¶17-380 Waiver — questions in the proposal. Insurance policies usually arise from completion of a proposal form (¶17-075). The duty of disclosure is applicable, but is not limited to answering all the questions in the proposal. The duty, both at common law and under sec 21 of the *Insurance Contracts Act*, is to disclose all material facts irrespective of whether there is a relevant question in the proposal (or even a proposal form at all).

However, the duty of disclosure may be limited by the nature of the questions in the proposal. The test at common law is: would a reasonable person reading the proposal be justified in thinking that the insurer had agreed to waive its right to receive, or was indifferent as to whether it received, all material information?¹⁷

15. [1999] NSWCA 1043; (2000) 11 ANZ Insurance Cases ¶61-463.

17. *Schoolman v Hall* [1951] 1 Lloyd’s Rep 113 at pp 142-143.

16. *Australian Motorists and General Insurance Co Pty Ltd v Andrews* (1974) 48 ALJR 195.

The *Insurance Contracts Act* clarifies the position. Where an applicant fails to answer, or gives an obviously incomplete or irrelevant answer to, a question in a proposal, the insurer will be deemed to have waived compliance with the duty of disclosure in relation to that matter (sec 21(3)). In addition, the insurer's ability to vary the duty of disclosure by the terms of the contract (eg the language of the declaration in the proposal, or by conditions of the policy) is strictly limited by sec 52 of the *Insurance Contracts Act* which prohibits "contracting out" of the operation of the Act to the prejudice of the insured. (Common law principles continue to apply where the Act does not (¶17-035).)

¶17-390 Materiality — the test. In Australia the accepted test of materiality at common law is as follows:

"a fact is material if it would have reasonably affected the mind of a prudent insurer in determining whether he will accept the insurance, and if so, at what premium and on what conditions. The word 'reasonably' is necessary to maintain control over the evidence of possibly absurd stringent insurance practice."¹⁸

The "reasonable insured" test is not correct at common law, although it has been said that "there will be few cases where the application of the 'prudent insurer' test would lead to a different conclusion from that which would have been arrived at by the application of the 'reasonable insured' test".¹⁹ At common law, the particular insured's opinion regarding the materiality of a fact is irrelevant, as is the particular insurer's belief that a fact is material: the test is that of a "prudent insurer". It is less certain if the undisclosed fact should have actually affected the prudent insurer's final decision to accept the risk and, if so, on what terms, or if the undisclosed fact need only be an influencing factor in reaching those decisions.

Section 21 of the *Insurance Contracts Act* eases the strictness of the common law test of materiality by requiring the insured to disclose matters which the insured knows to be relevant to the insurer's decision to accept the risk and, if so, on what terms, or which a person in the circumstances of the insured could reasonably be expected to know to be so relevant. Thus the statutory test focuses upon the actual insurer and insured concerned, as well as incorporating to some extent the "reasonable insured" test.

¶17-400 Examples of material facts. Although each case depends upon its own particular circumstances, it is possible to single out various matters which will generally be material at common law and under the *Insurance Contracts Act*:

18. *Mayne Nickless Ltd v Pegler* [1974] 1 NSWLR 228 at p 239.

19. *Liga Knitting Mills v Lombard Insurance Co Ltd* (1984) 3 ANZ Insurance Cases ¶60-551 at p 78,258.

- Insurance and loss history of applicant, in particular previous claims and whether an applicant has been refused insurance or had insurances cancelled.²⁰
- Criminal convictions. Regardless of their direct relevance to the risk under consideration, criminal convictions (other than minor summary offences) will generally be material on the basis that a convicted person may be less trustworthy than other applicants ("moral hazard").²¹ Convictions may become stale in time.²² Insurers should ensure that they do not breach the federal law on spent convictions.²³
- Name and occupation. An insurer would be justifiably suspicious if the applicant were known by a name different from that disclosed, and similarly, the applicant's occupation may also be material (certainly where it is hazardous).
- Health. Major illness²⁴ and operations are obviously important, especially in life and personal accident insurance. There are dicta that, for example, sore throats, colds and everyday ailments, and chest pains while jogging²⁵ are not, by themselves, material facts.
- Exposure of insurer to increased risk. Storage of highly flammable liquid, and the type of construction used for a building, eg timber, are examples of material facts at common law and under the *Insurance Contracts Act*.

20. eg *Evans v Sirius Insurance Co Ltd* (1986) 4 ANZ Insurance Cases ¶60-755: see ¶17-360; *Barclay Holdings (Aust) Pty Ltd v British National Insurance Co Ltd* (1987) 8 NSWLR 514; (1987) 4 ANZ Insurance Cases ¶60-770 (rescinded decision not to renew immaterial).

21. eg *Woolcott v Sun Alliance and London Insurance Ltd* [1978] 1 All ER 1253 (noted at (1978) 52 ALJ 645 and (1979) 53 ALJ 146); *Antolovich v Sun Alliance Insurance Ltd* (1989) 5 ANZ Insurance Cases ¶60-915 (builder who failed to disclose 17-year criminal record of owner (in prison at the time) of house he was building was unable to claim under the policy when house was destroyed by fire).

22. In *Edwards v AA Mutual Insurance Co* (1985) 3 ANZ Insurance Cases ¶60-668 an eight-year-old conviction for stealing \$19 worth of goods was not material; in *Twenty-first Maylux Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd* [1990] VR 919; (1990) 6 ANZ Insurance Cases

¶60-954 a three-year-old conviction for being knowingly concerned in the importation and possession of 28.5kg of cannabis was material.

23. *Crimes Act 1914* (Cth) sec 85ZV. The spent convictions scheme protects from disclosure adult convictions which are more than 10 years old and juvenile convictions which are more than five years old, subject to two provisos: (a) the maximum penalty for the original offence must not have been greater than 30 months' imprisonment; (b) the individual must have remained free of conviction in the meantime. Any Australian with an old federal conviction has the right not to disclose it where it meets the above guidelines.

24. Such as kidney cancer: *Summerton v SGIC Life Ltd* (1999) 10 ANZ Insurance Cases ¶90-102.

25. *Baker v Australian American Insurance Co Ltd* (1984) 3 ANZ Insurance Cases ¶60-592.

¶17-410 Onus of proof. Both at common law, and under the *Insurance Contracts Act*, the onus of establishing the non-disclosure of a fact and its materiality lie squarely upon the insurer. The common law standard established that the materiality of the disclosed fact depended upon the “prudent insurer” test (see ¶17-390) which generally meant evidence of the practice of the insurance industry. The statutory test under the *Insurance Contracts Act* places less emphasis on the practice of the insurance industry, and focuses on the actual insurer as well as “a reasonable person in the circumstances” (sec 21(1): ¶17-390).

¶17-420 Effect of non-disclosure. At common law the innocent party can avoid the contract *ab initio* for non-disclosure of a material fact (premiums are repayable if the insurer avoids the contract).²⁶

Under the *Insurance Contracts Act* an insurer’s remedies depend on whether the non-disclosure is fraudulent or innocent.²⁷ (The remedies under the Act discussed below apply in relation to both non-disclosure and misrepresentation.)

Where a non-disclosure or misrepresentation is fraudulent (ie deliberate or reckless), the insurer is able to avoid the contract, irrespective of the type of insurance (general insurance: sec 28(2), life insurance: sec 29(2)).

Court may disregard avoidance in certain circumstances: sec 31. Section 31 provides that if an insurer has avoided a contract on the grounds of fraudulent failure to comply with the duty of disclosure (¶17-330) or fraudulent misrepresentation (sec 28), the court may disregard the avoidance if:

- the insurer’s avoidance of the contract would be “harsh and unfair” (sec 31(1)); and
- the insurer has not been more than minimally or insignificantly prejudiced by the insured’s breach (sec 31(2)).

For example, an insurer could not reject a claim because of a minor overstatement of the value of a car in an “agreed value” motor vehicle policy, because the insurer accepted the terms of the risk. The overstatement of value could only affect the extent of the indemnity, not the acceptance or otherwise of the insurance proposal.²⁸

26. An insured is not entitled to damages (but can recover premiums upon avoiding the contract) where the insurer is in breach of the duty, unless the insured can maintain an action in tort or for misrepresentation: *Banque Financière de la Cité SA (formerly Banque Keyser Ullman SA) v Skandia (UK) Insurance Co Ltd* [1990] 3 WLR 364; (1990) 6 ANZ Insurance Cases ¶60-987, noted (1990) 64 ALJ 740, ¶17-330.

27. Sec 33 of the *Insurance Contracts Act* provides that the common law remedies are unavailable as remedies for non-disclosure and misrepresentation where the Act applies (¶17-035).

28. *Von Braun v Australian Associated Motor Insurers Ltd* (1999) 10 ANZ Insurance Cases ¶61-419.

However, sec 31 does not give the court discretion to avoid non-disclosure by the insured after the contract is formed (such as non-disclosure of the fitting of mag wheels to a car).

If an insurer is not able to, or chooses not to, avoid a contract of general insurance for non-disclosure or misrepresentation, the insurer's liability in respect of the claim is reduced to the amount that places it in the position in which it would be if the relevant matter had been disclosed or the misrepresentation had not been made (sec 28(3)). If the insurer would still have entered into the contract, for the same premium and on the same terms and conditions, if disclosure had been made, or if there had been no misrepresentation, the insurer has no remedies (sec 28(1)).

— *Case example* —

In August 1986, Mr and Mrs P lodged a claim for burglary on their home contents policy issued by insurer D earlier in the same month. Following investigations, the claim was rejected by D on the grounds of non-disclosure of material facts in answer to the following questions in the proposal:

Q. "Have you ever had any ... claim rejected?" A. No (In 1980 a fire claim lodged by a business in which Mr P was a partner had been initially rejected, but the claim was later settled.)

Q. "Are there any other facts relating to the risks ... which should be disclosed to enable a true assessment of the application ...?" A. No (This question was considered by the Court of Appeal to be virtually co-extensive with the statutory duty of disclosure. In evidence, Mr P said he did not understand the question.)

Q. "Have you ever had a loss ... over \$1,000?" A. No (Mr and Mrs P's home had been burgled in July 1986 with the loss of a video recorder, a radio cassette and a microwave oven which had cost them less than \$1,000 but which had a replacement cost of over \$1,000. Though untrue and constituting a misrepresentation in response to an ambiguous question (¶17-100), the trial judge confirmed that Mr P's answer to this was false but that insurer D's liability should not be reduced under sec 28(3) as it could not be concluded that the policy would not have been issued if the truth had been revealed. Deciding in favour of Mr and Mrs P, the trial judge ordered insurer D to provide indemnity under the policy.

Insurer D's appeal to the New South Wales Court of Appeal — that it was entitled to reject the claim under sec 28 for Mr P's failure to disclose his partnership rejection in 1980 — was unsuccessful. The reference in the proposal to "you" was confirmed in the case of a joint policy to be joint and several (cf ¶10-240) and to refer to the joint owners of the property forming the subject of a joint loss (ie Mr and Mrs P) and (in the absence of words to the contrary) their individual property as well. For the purposes of sec 21, the Court of Appeal held that each party is an "insured", and although Mr P was in breach of sec 21 regarding the non-disclosure of the partnership claim, Mrs P was not in breach, because she was unaware of the claim: insurer D could therefore only reject the claim on the ground of fraudulent failure of both Mr and Mrs P. This decision was reversed by the High Court.

The High Court held that insurer D could avoid the contract for non-disclosure of these material facts in their composite or joint policy by Mr P even though

unknown to Mrs P. The duty of good faith imposed by sec 13 and 14 (¶17-310) does not lead to a joint duty to disclose under sec 21 (¶17-330—¶17-400) only joint acts and omissions of the co-insured. Because D had an interest in the individual history and the claims record of each applicant, the questions in the proposal should be read as directed to each of the insured, and because sec 21 imposes this duty on each applicant, sec 28 allows an insurer to avoid the contract for failure to disclose by one co-insured.

The case was to be referred back to the trial judge to determine the application of sec 21 to the facts. In particular, if D could avoid the contract, could it reduce its liability under sec 28(3) to nil?

— *Advance (NSW) Insurance Agencies Pty Ltd v Matthews & Anor*²⁹ —

Later decisions have confirmed that the insurer can reduce its liability to nil under sec 28(3) if, had it been aware of the matter not disclosed or misrepresented, the insurer would not have entered the contract in the first place.³⁰ The damage suffered by the insurer is the total amount of the claim. Section 28(3) therefore offers the insurer an indirect means of avoiding a policy in the event of innocent non-disclosure or misrepresentation (¶17-480).

In the case of life insurance, the insurer can avoid the contract within three years of its being entered into if there is non-disclosure or misrepresentation which is not fraudulent (sec 29(3)). If the insurer does not avoid the contract, within the first three years it can vary it from its beginning by reducing the sum insured in accordance with a formula based on proportionality (sec 29(4)). Section 29 does not apply where the non-disclosure or misrepresentation relates to the life insured's age (see ¶17-480), nor where the insurer would still enter into the contract even if disclosure were made (sec 29(1)).

An insurer can cancel a contract of general insurance, without affecting any prior claim, where there has been a non-disclosure or a misrepresentation (sec 60) (¶17-680).

BASIC CONCEPTS UNDERLYING INSURANCE LAW: IV. MISREPRESENTATION

Statements of fact and opinion	¶17-450
Misrepresentation of fact — ambiguities	¶17-460
Materiality of misrepresentation	¶17-470
Innocent and fraudulent misrepresentation	¶17-480

¶17-450 Statements of fact and opinion. Section 26(1) of the *Insurance Contracts Act* sets out the basis upon which an untrue statement will not amount to a misrepresentation. It protects the insured who reasonably

29. (1989) 166 CLR 606; (1989) 5 ANZ Insurance Cases ¶60-910; applied, eg, *MMI General Insurance Ltd v Baktoo* [2000] NSWCA 70; (2000) 11 ANZ Insurance Cases ¶61-466.

30. eg *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 72 ALJR 937, ¶17-560; Sutton, KCT, *Insurance Law in Australia*, LBC, 3rd ed, 1999, para 3.140. The insurer's liability can also be reduced to nil under sec 54: ¶17-640.

believes an untrue statement to be true; such a statement will not be treated as a misrepresentation if a reasonable person in the circumstances could be expected to have believed it to be true. In addition, sec 26(2) provides that a statement by an insured will not be treated as a misrepresentation unless the insured knew, or a reasonable person in the circumstances could have been expected to know, that the statement would have been relevant to the insurer's decision to accept the risk and, if so, on what terms. The onus of proving the application of sec 26(1) lies on the proponent, whereas the onus of proof of sec 26(2) lies on the insurer.

At common law a misrepresentation by one person entitles the other to rescind (¶15-700):

— *Case example* —

Misrepresentation at common law. A proposal for a partnership professional indemnity policy asked whether any of the partners were aware of any circumstance which might give rise to a claim against the firm. One of the partners was aware of a possible claim, but the signing partner innocently and in ignorance answered "No". The insurer was entitled to disclaim liability under the policy for misrepresentation and non-disclosure.

— *Yorkville Nominees Pty Ltd (in liq) v Lissenden*³¹ —

¶17-460 Misrepresentation of fact — ambiguities. An ambiguity in a question in the proposal is to be read subject to the principle of reasonable construction of a question, reflected in sec 23 of the *Insurance Contracts Act* (¶17-100). Also, sec 27, which provides that a person is not taken to have made a misrepresentation solely because of a failure to answer a question or because of providing an obviously incomplete or irrelevant answer in a proposal form (¶17-110), further restricts the insurer's right to rescind by alleging misrepresentation, as do the provisions of sec 26 (¶17-450).

At common law an ambiguity in a question in a proposal is construed *contra proferentem* (¶17-620) and if on a fair and reasonable construction of a question the answer is not false, there is no misrepresentation.

¶17-470 Materiality of misrepresentation. The test of materiality under the *Insurance Contracts Act* is similar to that in relation to non-disclosure under sec 21 of the Act (¶17-390). Thus a statement made by a person in connection with a proposed contract of insurance will not be a misrepresentation, unless the person who makes the statement knows, or a reasonable person in the circumstances can be expected to know, that the statement will be relevant to the decision of the insurer whether to accept the risk and, if so, on what terms (sec 26(2)).³²

31. (1986) 160 CLR 475; (1986) 60 ALJR 218; ¶10-210.

32. At common law the test of materiality is the same as for non-disclosure, ie whether

the representation would have induced a prudent insurer/applicant to enter the proposal/offer at the premium and terms decided upon (¶17-390, ¶17-400).

¶17-480 Innocent and fraudulent misrepresentation. A distinction can be made between an innocent or unintended misrepresentation and a fraudulent misrepresentation. At common law the innocent party can avoid the contract in either case; where the misrepresentation is fraudulent, the innocent party can also sue for damages in the tort of deceit (¶5-700).

Under the *Insurance Contracts Act* the remedies for misrepresentation³³ are the same as for breach of the duty of disclosure (see ¶17-420), therefore maintaining the distinction between innocent and fraudulent misrepresentation. A misrepresentation made by the life insured is to be treated as if made by the insured (sec 25).

Special provisions apply where a misrepresentation relates to the life insured's age. Under sec 30 of the *Insurance Contracts Act*, a policy may not be avoided for mis-statement of the life insured's age, but it may be adjusted under the formula set out in the section. Sections 83 and 84 of the *Life Insurance Act 1945* (Cth) also protect insureds.³⁴

INTERMEDIARIES

The role of intermediaries	¶17-500
Agent of insurer or insured?	¶17-520
Principal and third party	¶17-540
Proposal completed by agent	¶17-550
Principal and agent	¶17-560
Premiums paid to intermediaries	¶17-570
Remuneration of intermediaries	¶17-580
Regulatory control of intermediaries	¶17-590

¶17-500 The role of intermediaries. All insurance business is arranged through intermediaries, whether employees of insurance companies, agents or brokers. The main difference between agents and brokers lies in independence and expertise. Unless acting under a binder (¶17-520), a broker

33. Where the insurer would enter into the same contract, whether of general or life insurance, even if the misrepresentation were not made, none of the statutory remedies are available to the insurer (sec 28(1), 29(1)).

34. Under sec 84 a life policy cannot be avoided because of an incorrect statement in a proposal or other pre-contract document, unless it was fraudulently untrue or was material to the risk. Under sec 86A, sec 83 and 84 of the *Life Insurance Act 1945* (Cth) do not apply to life insurance contracts entered into in

or after 1986 and to which the *Insurance Contracts Act 1984* (Cth) applies. These sections are "saved" by sec 264 of the *Life Insurance Act 1995* (Cth). Contracts of insurance not regulated by the *Insurance Contracts Act 1984* (Cth) (¶17-035) are subject to consumer protection legislation, eg *Trade Practices Act 1974* (Cth), *Instruments Act 1958* (Vic) sec 25, *Insurance Act 1902* (NSW) sec 18, 18A (¶17-120); *Misrepresentation Act 1972* (SA), *Law Reform (Misrepresentation) Act 1977* (ACT) (¶5-700).

is not generally "tied" to any insurer.³⁵ Other intermediaries include part time agents such as solicitors, financial institution staff, real estate agents, travel agents and car traders (who may arrange insurance but only as an incidental part of their main business activity), and loss adjusters or loss assessors.

The rights, responsibilities and duties of insurance intermediaries are governed by statute law and common law principles. In addition to the *Insurance (Agents and Brokers) Act 1984* (Cth), the *Insurance Contracts Act 1984* (Cth) and the *Australian Securities and Investments Commission Act 1989* (Cth) (the ASIC Act), the main legislation affecting intermediaries is the *Trade Practices Act 1974* (Cth) (the TPA) Part V (Consumer Protection) — an intermediary's eagerness may later be construed as "misleading or deceptive" conduct under sec 52 (¶7-250ff). The implied warranties in TPA sec 74/ASIC Act sec 12ED in relation to the supply of services do not apply to services supplied under a "contract of insurance" (sec 74(3): ¶7-095; ¶17-310).

— *Case example* —

On the advice of the bank manager, the insured did not disclose his medical condition in his proposal for an accident or illness policy (¶17-040) issued through the bank as part of an "insured personal loan". A claim by the insured was rejected for non-disclosure. The bank manager's advice was held to be misleading (in breach of *Trade Practices Act 1974* (Cth) sec 52: ¶7-250ff) and negligent (in breach of *Trade Practices Act* sec 74: ¶7-095). In respect of sec 74, the financial services were not "provided ... under ... a contract of insurance", but in the course of the business of banking — obtaining the contract of insurance was part of the services provided. The court awarded P the cover under the policy that the bank manager had described, by varying the loan contract under sec 87(2)(b) (¶8-860) to delete loan repayments for the period during which the insurance company would have paid them, had the cover been effective.

———— *Warnock v Australia and New Zealand Banking Group Ltd*³⁶ ————

In addition, insurance intermediaries act subject to the law of contract, agency law (Chapter 11) and the negligent mis-statement principles of the law of tort (¶4-230ff).

35. An agent may be "tied" to just one insurance company or to a number (a "multi-agent"). Multi-agents are to notify insurers of all agency agreements in place under sec 33A.

36. (1989) 5 ANZ Insurance Cases ¶60-897, noted (1990) 64 LIJ 1158, ¶7-095. Similarly, *SWF Hoists & Industrial Equipment Pty Ltd v State Government Insurance Commission* (1990) 6 ANZ Insurance Cases ¶61-002 (insurer liable for damages under sec 52 and 53(g) for representations by its agent that workers'

compensation policy would cover a worker while working interstate). Contrast *Zoneff v Elcom Credit Union Ltd* (1991) 6 ANZ Insurance Cases ¶61-023 (no damages under sec 52 or 52A for alleged inadequacy of policy, because no evidence of reliance on insurer). The representations of an insurer about its competitor's policy may also be misleading or deceptive under sec 52: *RAIA Insurance Brokers Ltd v FAI General Insurance Co Ltd* (1993) 41 FCR 164, ¶7-250.

¶17-520 Agent of insurer or insured? At common law, insurance brokers have been regarded as agents (¶11-010ff) of insureds and intending insureds, even though their remuneration is principally by way of commission (brokerage) from insurers (see ¶17-580). Sometimes, however, brokers act for insurers, for example under written agreements called “binders” (defined in sec 11), while on occasion they may act for both parties in the same transaction, leading to a potential conflict of interest.³⁷ “Tied” agents and insurers’ employees are considered to be agents of insurers, although at common law they have been deemed to have been acting for insureds or intending insureds for particular purposes such as completing proposal forms (see ¶17-550).

Section 12 of the *Insurance (Agents and Brokers) Act 1984* (Cth) deems every insurance intermediary to be the insurer’s agent, in relation to any matter relating to insurance and as between an insured or intending insured and an insurer, with the exception of a (registered) insurance broker acting in relation to the class of insurance (general or life) in respect of which the broker is registered (see ¶17-590). In such a case, the broker is the insured’s or intending insured’s agent. But where, for example, a broker registered only in respect of general insurance business acts in relation to life insurance business, the broker will be the insurer’s agent.

An intermediary acting under a binder is also deemed to be the agent of the insurer under sec 15. A binder is defined in sec 9 to mean an agency authority given by an insurer.

A broker or other insurance intermediary who intends to act under a binder in arranging a contract of insurance must first inform the intending insured that the intermediary will be acting under an agreement with the insurer and will be effecting the contract as the insurer’s agent (sec 16(1)(a)). Failure to do so will make that contract voidable at the option of the insured.

¶17-540 Principal and third party. At common law the principal is bound by any acts of the agent, however improperly or negligently carried out, which are within the agent’s actual or ostensible (or apparent) authority, even if the principal directed the agent not to do the act in question.

Actual authority may be express or implied (see ¶11-110—¶11-120). For example, if an agent is given blank cover notes by an insurer, the agent has implied authority to issue the cover notes and thus effect interim cover binding on the insurer.

Ostensible or apparent authority (see ¶11-130) arises from the principal’s words or conduct by which the agent is held out as having certain authority. Thus the appointment of an agent to a particular position confers on the agent ostensible authority to bind the principal in respect of those acts which someone in that position would usually have authority to do.

37. See *Anglo-African Merchants Ltd v Bayley* [1970] 1 QB 311; [1969] 2 All ER

421; *North and South Trust Co v Berkeley* [1971] 1 All ER 980.

Where the act falls entirely outside the scope of the agent's authority (actual or ostensible), the principal will not be bound at common law. In contrast, under sec 11(1) of the *Insurance (Agents and Brokers) Act*, the insurer is responsible for the conduct of its agent (including sub-agents) or employee even if the agent (or sub-agent) or employee did not act within the scope of authority or employment. From 1 October 1994, insurers are jointly and severally liable for the actions of multi-agents (sec 11, amended by the *Insurance Laws Amendment Act 1994*). Intermediaries, other than brokers (unless acting under a binder), are deemed to be the insurer's agent (sec 12) (¶17-520).

Unauthorised acts of an agent can be ratified by the principal (see ¶11-090). Where an agent claims to have a particular authority which it does not have, the agent will be liable to the third party for breach of warranty of authority (¶11-330), including where the insurer is bound by the agent's conduct under sec 11 (if so, the insurer may be able to sue the agent for breach of the duty to use reasonable care and skill (see ¶17-560)).

Under the *Insurance (Agents and Brokers) Act*, an insurance intermediary (other than a broker) cannot arrange, or hold itself out as entitled to arrange, contracts of insurance as agent for an insurer unless there is a written agreement authorising the intermediary to act as the insurer's agent (sec 10).

An agent's knowledge will be imputed to the principal at common law if the agent acquires the knowledge acting within the scope of the agent's authority, actual or ostensible. An agent's knowledge of the truth will not be imputed to the principal at common law if the agent takes part in a fraud by deliberately concealing or misrepresenting a fact. However, under sec 11, the insurer may be bound by the agent's knowledge, but not if the insured is party to the agent's fraud.

¶17-550 Proposal completed by agent. Agents often complete proposal forms on behalf of applicants. If correct information given by the applicant is misrecorded by the agent and the applicant signs the form without correcting any error, the applicant will in general be bound by the contents of the form at common law, since in law people are bound by what they have signed (see ¶6-190).³⁸ However, the effect of sec 11 of the *Insurance (Agents and Brokers) Act* is to provide that an insurer is responsible for the conduct of its agent or employee in completing the form, where it is reasonable for the insured to rely upon the agent to do so (¶17-540).

— *Case example* —

P (a restaurant proprietor) approached insurance broker A to arrange insurance cover over P's house and contents. A arranged cover with Insurer 1, and forwarded to P the cover note and proposal for P's attention. Because P did not return the documents, and a rate rise intervened, A took it upon himself in P's interests to obtain alternative insurance at the "old" rates with Insurer 2. On 23 March, Insurer 2 issued a cover note for one

38. *Jumna Khan v Bankers & Traders Insurance Co Ltd* (1925) 37 CLR 451.

month. Almost immediately, and before Insurer 2 had received a proposal form, P submitted a claim form to Insurer 2 following a burglary at his house on 27 March.

A, without informing P, filled in Insurer 2's proposal and counterfeited P's signature, but did not disclose in the proposal the value of jewellery kept by P on the premises.

Insurer 2 denied P's claim for indemnity for non-disclosure of a material fact (¶17-330ff) namely the value of the jewellery kept on the premises. A was prosecuted by the Commonwealth Director of Public Prosecutions (¶2-140) for breach of the *Insurance (Agents and Brokers) Act 1984* (Cth) sec 13(2)(a) (wilfully and with intent to deceive, writing matter that is false or misleading), and upon conviction was fined \$300 and ordered to pay the prosecution costs.

*Simeone v Vorreiter*³⁹

¶17-560 Principal and agent. The respective rights and duties of the principal and the agent must be determined by reference to the agency contract, express or implied, which exists between them. However, certain duties will always be implied, in particular the duty of an agent to use reasonable care and skill in performing the terms of the contract (see further ¶11-140ff). Thus, in situations discussed above (see ¶17-540), where the agent's negligent conduct renders the principal liable, the principal may be able to sue the agent for breach of that duty (¶11-160).⁴⁰

The duty of reasonable care and skill owed by an agent to its principal (¶11-160) often arises in the context of broker/client. The insurance broker's primary duty (whether under contract or in tort) is to exercise proper care and skill in carrying out the insured's instructions. For example, a broker would know that if it caused an insured to breach its duty of disclosure, there would be a high probability that the insurer would repudiate liability to fully indemnify the insured, and that the insurer would have the right to reduce its liability to nil under sec 28(3) (¶17-420). In such a situation, the broker may be liable to make up the difference to the insured for its failure to ensure effective insurance cover.⁴¹ The broker must take all reasonable care to procure insurance appropriate for the client's needs, including obtaining cover against all foreseeable and insurable risks, and must advise the client if unable to obtain the appropriate cover. The broker's duty extends to pointing out pitfalls in different policies. A broker should also take care in recommending or selecting an insurer, in particular taking reasonable steps to see that the insurer selected is sound and reliable.

39. (1990) 6 ANZ Insurance Cases ¶60-955; (1990) 92 ALR 288.

40. An action is more likely to be framed in tort than in contract: *Hawkins v Clayton* (1988) 164 CLR 539; (1988) Aust Torts Reports ¶80-163 (¶4-040).

41. eg *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 72 ALJR 937, noted (1999) 73 ALJ 23.

An insurance agent or broker may also be liable under the *Trade Practices Act 1974* (Cth) and the parallel provisions of the *Australian Securities and Investments Commission Act 1989* (Cth) which target misleading or deceptive conduct, false representations, other unfair practices and unconscionable conduct (§17-250ff; §17-310).

In addition, an agent or broker may be liable under contract law (and the statutory warranties of "due care and skill" imposed by the *Trade Practices Act* (§17-095) and the *ASIC Act* (§17-310)). The tort of negligence applies for breach of the duty to exercise reasonable care and skill (§4-260) if, having been supplied with the correct information, the broker incorrectly completes a proposal form on behalf of the client.⁴² Furthermore, if the broker is aware of material facts the broker's duty is to disclose them to the insurer.

Provisions of the *Insurance Contracts Act* relating to the giving of information, notices, etc by an insurer to an insured or intending insured (other than a renewal notice under sec 58: §17-680)⁴³ include sec 22 (duty to inform of the duty of disclosure: §17-330), sec 37 (notification of any unusual terms of the contract: §17-610), sec 44 (notification of any average provision included in the contract: §17-850) and sec 49 (notification that contract does not provide cover for interests of non-insureds: §17-230). These notice provisions do not apply where a contract is arranged by a broker who is not acting under a binder but as the intending insured's agent (sec 71). Brokers are expected to know what information must be given to an intending insured and, as the insured's agent, are expected to give the insured all the required information. Failure to do so may constitute professional negligence.

§17-570 Premiums paid to intermediaries. Moneys received by a registered broker from an insured or intending insured are to be paid into an "Insurance Broking Account", the use of which is limited by the *Insurance (Agents and Brokers) Act 1984* (Cth) sec 26.

Section 14 reverses the previous common law and provides that payments to an insurance intermediary are treated as received by the insurer so long as there is an existing liability of the insured to the insurer. Thus where the broker goes into liquidation or absconds with the premium, the insured is not liable under the Act to pay it a second time.

— Case example —

*The Newcastle earthquake.*⁴⁴ D (the insurer) sent a renewal notice to P's (the insured's) broker for renewal of P's fire and liability insurance. P instructed the broker to renew the policy, and sent its cheque to the

42. It is a criminal offence for an intermediary to insert false material wilfully and with intent to deceive (§17-550).

43. For the purposes of giving information, notices, etc under the Act to an insured or intending insured, an insurance

intermediary other than a broker not acting under a binder (see §17-520) is deemed to be the insurer's agent (sec 71(3)).

44. Another case resulting from the same earthquake is set out at §17-760.

broker. Seven months later P's property was damaged in the Newcastle earthquake of 1989. The broker did not forward P's renewal instructions or pay P's premium to D, and D rejected P's claim on the basis that the policy had lapsed. P sued.

1. *Supreme Court*. Rogers CJ held in favour of P: "The insurance market will only work appropriately if payment to the broker of money on account of premium by an intending insured effects a renewal of the policy on the terms said to have been offered in the renewal notice".¹ (If this were not the law, the insured would always have to deal direct with the insurer.)
2. *Court of Appeal*. Two of the three judges upheld the view of Rogers CJ, but their judgment was based on an issue not argued before the court.² This was seen as "procedural unfairness", and was the basis for the appeal to the High Court.
3. *High Court*. By a majority of 3 to 2, the High Court allowed the appeal from the Court of Appeal. The High Court confirmed that the prerequisite to the operation of sec 14(2) is a contract — an existing "liability of the insured". Section 14 did not displace the rule of contract law that there was no contract, because P's acceptance of D's offer of renewal had not been communicated to D (¶5-310). The broker is not D's agent for acceptance of communications (¶17-520). Section 14(2) was not wide enough to authorise the creation of a contract between P and D. Because P's contract had not yet been renewed, there was no liability to be discharged by payment to the broker, and P's payment to the broker was not payment to D.

P lost this case in the High Court, but P's interpretation of sec 14 was actually supported by five of the nine judges in three jurisdictions.

_____ *Manufacturers' Mutual Insurance Ltd v John H Boardman Insurance Brokers Pty Ltd*³ —

Credit-term limits. A non-broker intermediary who receives premium moneys from an insured or intending insured must forward that amount to the insurer within 37 days of receipt (sec 37(2A) and (2B) amended by the *Insurance Laws Amendment Act 1994* with effect from 1 October 1994). This maximum time for holding moneys allows for normal commercial arrangements (ie monthly settlement) to operate.

Intermediaries may be granted an exemption from this requirement (under specified circumstances and with the insurer's consent) in which case the moneys received may be paid as soon as reasonably practicable (sec 37(2C); 37A).

1. *Metrot Pty Ltd v Manufacturers' Mutual Insurance Ltd* (1990) 21 NSWLR 220; (1990) 6 ANZ Insurance Cases ¶61-005 per Rogers CJ.

2. *Manufacturers' Mutual Insurance Ltd v John H Boardman Insurance Brokers Pty*

Ltd (1992) 27 NSWLR 630; (1992) 7 ANZ Insurance Cases ¶61-132.

3. (1994) 179 CLR 650; (1994) 8 ANZ Insurance Cases ¶61-215.

¶17-580 Remuneration of intermediaries. To further the cause of impartiality of brokers (brokers may be tempted to place business with insurers offering the highest brokerage), and to enable the consumer to assess the cost-competitiveness of different brokers, the *Insurance (Agents and Brokers) Act* provides as follows:

- An insurance broker who arranges an insurance contract must inform the insured of any fees imposed by the broker and, upon request, disclose to the insured any commission or other remuneration received by the broker from the insurer (sec 32).⁴
- An insurance broker who does not act under a binder may not receive, and an insurer may not pay, remuneration at a rate that varies in accordance with the level of business placed by the broker with that insurer (sec 35).
- An insurance broker is not bound by any agreement which prevents the broker from placing business with any insurer the broker wishes (unless effecting a contract under a binder) (sec 29).
- An insurance broker has to disclose to an intending insured for whom the broker proposes to arrange insurance any association with the proposed insurer (sec 38).

(For remuneration in the agency context, see also ¶11-220.)

¶17-590 Regulatory control of intermediaries. Insurance intermediaries are regulated by Commonwealth legislation (by the *Insurance (Agents and Brokers) Act 1984* and to a lesser extent by the *Life Insurance Act 1995* and the *Insurance Act 1973* (sec 113)) and by State legislation in South Australia.

The Australian Securities and Investments Commission (ASIC: ¶9-380; ¶17-310) is responsible for the administration of the *Insurance (Agents and Brokers) Act 1984*. This includes responsibility for the registration of insurance brokers and foreign agents and extends to an insurer's employees and agents.

Sections 18-31 of the *Insurance (Agents and Brokers) Act 1984* (Cth) and the *Insurance (Agents and Brokers) Regulations* provide a limited system of occupational control of intermediaries which (inter alia):

- makes it an offence to carry on insurance business as (i) an insurance broker unless registered with the Insurance and Superannuation Commissioner (sec 19(1)(a), 21); or (ii) as a non-broker intermediary without a written agreement with the insurer authorising the intermediary to arrange contracts of insurance as the insurer's agent (sec 10) (it is important to note that in renewing, refusing, suspending or cancelling an

4. A broker who acts under a binder does not have to disclose any commission, etc

received from the insurer where the broker complies with the disclosure requirements of sec 16 (¶17-520).

intermediary's registration the Commissioner is bound by the Insurance (Agents and Brokers) Decision-making Principles 1994);

- sets out the "ordinary obligations" to be met by "insurance intermediaries" and requires compliance with the provisions of the *Insurance (Agents and Brokers) Act* (Insurance (Agents and Brokers) Decision-making Principles 1994 sec 5);
- requires intermediaries to furnish information as directed by the Commissioner in relation to their business affairs or in relation to the investigation of an alleged offence under the *Insurance (Agents and Brokers) Act* (sec 34A-34U, inserted by *Insurance Laws Amendment Act 1994* with effect from 1 October 1994);
- requires multi-agents to give each principal written notice of existing and proposed agency agreements with other insurers (sec 33A, inserted by *Insurance Laws Amendment Act 1994* with effect from 1 October 1994);
- requires maintenance by brokers of (one or more) trust accounts ("Insurance Broking Accounts") with a bank or building society (sec 26);
- limits broker investment of insurance premiums, pending payment to the insurer, to prescribed investments (sec 26(4)) (¶17-570);
- prevents brokers from describing themselves or their businesses in a misleading way (sec 30);
- provides for payment of moneys received from an insurer for an insured (eg claims money) within seven days or as soon as practicable thereafter (sec 27(10));
- provides for premium amounts received by non-broker intermediaries from the insured to be paid to the insurer within 37 days of receipt (sec 37);
- requires brokers to have professional indemnity insurance (sec 9B, 19(1) and reg 3).

There are no registration or licensing requirements under the *Insurance (Agents and Brokers) Act* for insurance agents (except for registration and disclosure requests for foreign insurance agents: Part IIIA).

CONSTRUCTION OF THE INSURANCE POLICY —

Form and content of policies	¶17-610
Interpretation of policies	¶17-620
Insurer may not refuse to pay claims in certain circumstances	¶17-640
Warranties	¶17-650
Duration/cancellation/renewal	¶17-680

¶17-610 Form and content of policies. Insurance policies are often seen by the average insured as confusing standard form documents (¶5-780—¶5-810), although in recent years the insurance industry has made some moves to “plain English” policies.

Standard cover. Sections 34-37 of the *Insurance Contracts Act* regulate to some extent the contents of insurance contracts in six areas of “domestic insurance”, namely, motor vehicle (property damage only), home buildings and home contents, sickness and accident, consumer credit and travel insurance. Regulations (the *Insurance Contracts Regulations*) have been made under these sections prescribing “pre-printed standard cover” (in effect the events insured against, exclusions and the minimum amounts payable). For example, in the case of motor vehicle comprehensive insurance, the insurer must provide as a minimum “the amount sufficient to indemnify the person who made the claim” (reg 8(1)). A home building policy cannot exclude flood damage: “It is common ground that the Parliamentary intention ... is that, if sec 35(1) applies to the appellant’s contract of insurance, the exclusion for flood damage has no operation.”⁵ An insurer is not bound to follow these pre-printed standards, and can offer less than the standard cover if the insured is so informed by the insurer in writing before or at the time the contract is concluded, or is otherwise aware of it, or can reasonably be expected to be so aware (sec 35(2)). Standard terms are generally imposed under relevant State and Territory legislation in respect of compulsory insurance such as workers’ compensation and motor vehicle third party insurance.

Unusual provisions. An insurer can only rely on an unusual provision in a contract of insurance (in respect of which standard cover has not been prescribed) if it notifies the insured in writing before or at the time the contract is entered into of the effect of the provision (sec 37).

¶17-620 Interpretation of policies. The normal rules applicable to the construction of statutes (¶1-500—¶1-550) and contracts generally (Chapters 5 and 6) apply also to contracts of insurance, and the main task is to find out the presumed intention of the parties. To do this the policy must be read as a whole and in context. A fair and reasonable interpretation is to be preferred, having regard to the commercial purpose of the policy concerned.

Other established principles of interpretation are:

- Oral evidence cannot generally be used to contradict or to add to the terms of a contract in writing (the parol evidence rule: ¶5-030). As an exception to this rule, evidence of surrounding circumstances at the time the contract was made is admissible to assist in the interpretation of the contract if the language is ambiguous.
- Insurance industry practice can be relied upon if there was evidence that the insured was aware of that practice (¶6-120).

5. *Gray v Mercantile Mutual Insurance (Australia) Ltd* (1994) 63 SASR 154 at

p 165; (1995) 8 ANZ Insurance Cases ¶61-241 at p 75, 724.

even their natural and ordinary meaning
 ed technical meaning — so as to give
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 1-540).⁶

precedence over printed words in all

s “or other” follow an enumeration of
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Insurance Contracts Act (¶17-035) must be
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 ed is in breach of the insurance contract, the
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ne claim by an amount which represents the
 rer’s interests were prejudiced by the insured’s
 ain circumstances this could even be a reduction

ired’s breach caused or contributed to the loss

an CJ,⁷

6. *Rouleston Clarke Pty Ltd (in liq) v FAI General Insurance Company Ltd* [1999] TASSC 150; (2000) 11 ANZ Insurance Cases ¶61-465 at para [5]. See, eg, for “permanent total loss of use of one limb”: *Johnson v American Home Assurance Co* (1998) 72 ALJR 610 (injury to foot — insured’s loss not permanent with use of an orthotic); for “test” (read with “motor sport event, demonstration or test”): *Rogers v HIH Casualty and General*

Insurance (NZ) Ltd (2000) 11 ANZ Insurance Cases ¶61-462; for coverage for household contents at “the situation”: *Commercial Union Assurance Company of Australia Ltd v Hazelwood-Smith* [2000] VSC 137; (2000) 11 ANZ Insurance Cases ¶61-469.

7. *Greentree v FAI General Insurance Co Ltd* (1999) 10 ANZ Insurance Cases ¶61-423 at p 74,739.

"It is now authoritatively established that failure of an insured to notify the insurer under a 'claims made and notified' policy is an 'omission of the insured', 'by reason of' which 'the insurer may refuse to pay a claim', this being 'the effect of [the] contract of insurance', within sec 54(1) of the *Insurance Contracts Act 1984*.

The issue in this case is whether or not the failure by a third party to make a claim on the insured is an 'omission ... of some other person', within the terms of sec 54(1) in a 'claims made and notified' policy. I agree that it is not."

— *Case examples* —

Insurer not liable. The insured's failure to notify the insurer that the insured crane under an unregistered mobile machinery policy was registered was non-compliance with the policy's condition requiring notice. If the insurer had known the crane was registered, it would not have accepted the risk and its liability to the insured would have been nil — that is the "amount that fairly represents" the prejudice to the insurer's interests: "The prejudice will consist in the existence of a liability which, in whole or in part, would not have been borne by the insurer if the act had not been done or the omission had not been made or in the non-receipt of an additional premium to which the insurer would have been entitled by reason of the doing of the act or the making of the omission."

————— *Ferrcom Pty Ltd v Commercial Union Assurance Company of Australia Ltd*⁸ —

Insurer liable. The insured notified the insurer of a claim made during the period of cover of its professional indemnity policy six weeks after the policy had expired. But for sec 54, the insurer would have been entitled to deny liability for the insured's failure to give notice until after the policy had expired. The effect of sec 54 was to protect the insured's claim except to the extent that the insurer's interests were prejudiced. As they were not prejudiced by the late claim, the insured's case succeeded. The insurer's view that notification of the claim within time was a condition precedent to liability that could not be cured by sec 54 was therefore rejected.

— *East End Real Estate Pty Ltd t/a City Living v CE Heath Casualty & General Insurance Ltd*⁹ —

Insurer liable. An insurer was liable to indemnify a company director under a directors' legal expenses policy. The director had not obtained the insurer's consent to defend any claim as required by the policy. Section 54 relieves an insured's default, and it applied where the insurer had not given consent

8. (1993) 176 CLR 332 at p 342; (1993) 7 ANZ Insurance Cases ¶61-156 at p 77,831, noted (1993) 67 ALJ 556. Cross-claim dismissed: (1994) 8 ANZ Insurance Cases ¶61-218 and appeal dismissed: *Ferrcom Pty Limited v Inbush (NSW) Pty Limited* (1997) 9 ANZ Insurance Cases ¶61-339.

9. (1991) 25 NSWLR 400; (1992) 7 ANZ Insurance Cases ¶61-092 (NSW Court of Appeal), noted (1992) 20 ABLR 421; (1993) 21 ABLR 448. The claim when lodged was rejected: *East End Real Estate Pty Ltd t/a City Living v CE Heath Casualty & General Insurance Ltd* (1993) 7 ANZ Insurance Cases ¶61-151.

as required by the policy, provided there were reasonable grounds for the insured to defend the action against him.

_____ *Antico v Heath Fielding Australia Pty Ltd*¹⁰ —

Insurer liable. A hoist holding a car collapsed on a customer's car at P's workshop. When the customer sued P for compensation for the damage, P claimed on its insurer for indemnity under its policy of general insurance. Evidence showed that P had been negligent in the maintenance of the hoist. There was a "prevention of loss" clause in the policy which stated that the policy is voidable if the insured fails to take precaution to prevent loss, but the court held that because this clause did not impose a contractual obligation on P to maintain the hoist, sec 54 was not triggered: in the words of sec 54, "the insurer may not refuse to pay the claim". Section 54 is designed to improve the position of the insured, not to assist the insurer.

_____ *Lipari v Union des Assurances de Paris IARD*¹¹ —

Insurer liable. When the insured (a firm of auditors) became aware of a potential claim for professional negligence (¶4-230ff), the insured, on the basis of legal advice, chose not to inform its professional indemnity insurer.¹² Eighteen months later a claim was made against the insured, the insured then claimed and the insurer declined liability. The court held for the insured on the basis that sec 54 relieves default of the insured. The insurer could not refuse to indemnify the insured because its failure to give notice was an "omission" within the terms of sec 54.

_____ *Einfeld v HIH Casualty & General Insurance Ltd*¹³ —

¶17-650 Warranties. Warranties in insurance law can be classified as:

- warranties of existing fact (eg "I warrant that my car is in a roadworthy condition"), under which the insured guarantees a fact or set of circumstances;
- continuing or promissory warranties, under which the insured promises to do, or to refrain from doing, some particular act or series of acts (eg the insured warrants that he or she will not drive the insured motor vehicle "while there is present in his or her blood a concentration of 0.15 grams or more of alcohol in a hundred millilitres of blood").

10. (1997) 188 CLR 652; (1997) 9 ANZ Insurance Cases ¶61-371.

11. (1998) 10 ANZ Insurance Cases ¶61-415, noted (1998) 72 ALJ 937.

12. This policy covered "claims made and notified" during the period of the insurance regardless of when the act or omission giving rise to the claim occurred. In contrast, some professional indemnity policies are occurrence based and only cover an "occurrence discovered and

notified" during the period of the insurance.

13. (1999) 10 ANZ Insurance Cases ¶61-450, noted (1999) 27 ABLR 516 (Sutton). *FAI General Insurance Company Ltd v Perry* (1993) 30 NSWLR 89, which supported the earlier view that failure to give notice was inaction and not "omission" within sec 54, was overruled. See further Masel, G, *Taking liberties with claims made policies* (2000) 11 ILJ 104.

Neither of these meanings is the same as the meaning of “warranty” in contract law (¶6-050).

Breach of a warranty of existing fact. Section 24 of the *Insurance Contracts Act* provides that a statement made by the insured with respect to the existence of a state of affairs will not be treated as a warranty, and instead will be treated as a representation made by the insured to the insurer. Hence the insurer will not be able to avoid the contract automatically for breach by the insured; the remedies open to the insurer will be those for innocent misrepresentation and fraudulent misrepresentation (sec 28) (¶17-420).

Breach of a continuing warranty. Under sec 54 of the *Insurance Contracts Act* an insurer may not refuse to pay a claim because of a breach of a continuing warranty unless the breach caused the insurer prejudice. Instead, the insurer may only reduce the claim by the amount representing the prejudice actually suffered (see ¶17-640).

¶17-680 Duration/cancellation/renewal. The termination and renewal of insurance contracts can often create difficulties. Most non-life policies run for a period of 12 months, although most insurers will renew them for a further 12-month period and so on indefinitely.

Unless a policy of general insurance provides otherwise, an insured has no legal right to the renewal of the policy.

Statutory policy. The *Insurance Contracts Act* requires an insurer of “renewable insurance cover” — insurance which is taken out for a fixed period and which is usually renewed — to notify the insured at least 14 days before the expiry date whether it is prepared to renew the cover (sec 58). If the insurer fails to do this, and if the insured has not obtained alternative cover before the expiry date, the insurance is automatically extended under a “statutory policy” to the expiry of a period equal to the period of cover provided under the original contract *or* the time when the insured obtains alternative insurance, whichever is the earlier (sec 58(3)). No premium is payable for the statutory policy unless the insured makes a claim under it (sec 58(4)).

“[I]f the insurer has given notice in writing to the insured of proposed cancellation [in compliance with sec 59] ... thereafter the policy is not one which is set to expire within the meaning of s. 58.”¹⁴

Where an insurer refuses to renew a contract of insurance, it will have to give written reasons for its refusal if requested by the insured or the life insured, unless, in the case of life insurance where the insured is not the life insured, the only reason is the life insured’s health (sec 75: ¶17-075).

Section 210(1) of the *Life Insurance Act 1995* (Cth) prohibits an insurer from forfeiting a life policy on which not less than three years’ premiums

14. Because the insurer had given effective notice of cancellation, no statutory policy came into existence in *CIC Insurance*

Ltd v Bankstown Football Club Ltd (1997) 9 ANZ Insurance Cases ¶61-348; (1997) 187 CLR 384; ¶17-840.

have been paid for non-payment of a premium, if the surrender value of the policy exceeds the amount of the overdue premiums.

A renewal of a contract of insurance usually creates a new contract, and all the rules relating to the formation of insurance contracts, including the duty of disclosure (§17-330), apply to it. A renewal notice usually constitutes an offer to renew, which is accepted by payment of the premium.

Another clause commonly found in policies (particularly life policies) specifies that if premiums remain unpaid for a specified period (eg 30 days), the policy will be forfeited.

Cancellation. The *Insurance Contracts Act* limits an insurer's rights to cancel insurance contracts. Section 59 provides for written notice to be served on the insured, which will take effect at the time stated.

An insurer is only able to cancel a general insurance contract as specified in sec 60, including where the insured fails to comply with the duty of utmost good faith (§17-310), or the duty of disclosure (§17-330), makes a misrepresentation (§17-450ff) or a fraudulent claim (§17-790), or breaches a term of the contract. An insurer is able to cancel at any time an interim contract of general insurance and a contract extended by sec 58 (see above). Any attempted cancellation in contravention of the above provisions is void (sec 63). Because cancellation of cover is an important event and can affect a person's ability to arrange insurance,¹⁵ the insurer has to provide on request written reasons for cancellation (sec 75).

The *Insurance Contracts Act* does not affect the insured's right to cancel a non-life insurance contract (the contract must confer such a right¹⁶). One reform made by the Act is that an insured under a life insurance contract has a 14-day "free look" period from receipt of the policy, with the right to cancel the contract (sec 64).

Renewal. A renewal notice sent out by an insurer is an offer which is accepted by the insured by payment of the premium within the period specified in the notice (or, if no period is specified, before the policy expires). The duty of disclosure (sec 21) applies at renewal, and the insurer may lose its rights in the event of non-disclosure by the insured if it does not bring this to the attention of the insured in the renewal papers (sec 22: §17-330).¹⁷ Unless the terms of the offer specify to the contrary, acceptance will be effected when the renewal premium is posted, rather than when it is received by the insurer. Consequently it is usual for insurers to insert a clause to the effect that they

15. Cancellations, etc may be material facts which should be disclosed to any prospective insurers (§17-400).

16. Under a composite policy (one contract which insures separate interests) one co-insured cannot cancel the policy in respect of its interests without the co-insured's consent unless the policy provides

otherwise: *Federation Insurance Ltd v Wasson* (1987) 163 CLR 303; (1987) 4 ANZ Insurance Cases ¶60-794, noted (1987) 61 ALJ 814.

17. As in *Suncorp General Insurance Ltd v Cheibk* (1999) 10 ANZ Insurance Cases ¶61-442; §17-330; §17-350.

shall not be on risk until the premium is “actually received”. Notifying a broker of the insured’s intention to renew is not notification to the insurer under sec 14(2).

CLAIMS — NOTICE AND PROOF OF LOSS _____

Negotiations for settlement	¶17-700
Notice of loss	¶17-710
Proof of loss	¶17-760
Exclusions	¶17-775
Causation	¶17-780
Fraudulent claims, loss by own act, criminal and illegal acts	¶17-790
Arbitration	¶17-800
Insurance disputes in Small Claims Tribunals	¶17-805
Insurance industry complaints schemes	¶17-810
Waiver, election, estoppel	¶17-820

¶17-700 Negotiations for settlement. There must be an honest and realistic approach to settlement of a claim, so that the scope of the claim can be defined.¹⁸ “The insurer must be allowed a reasonable time within which to investigate a claim.”¹⁹

To bind insurer and insured a settlement of claim must satisfy the rules relating to the formation of a contract (see Chapter 5). The consideration (see ¶5-400) supporting the contract (of settlement) is the relinquishment of rights (such as the insured’s right to maintain a legal action under the policy), and payment by the insurer.

A document called a “release” is usually prepared by the insurer freeing both parties from further liability in respect of the claim. Once this agreement is concluded any further legal action in respect of the claim (such as action to compel payment according to its terms) is governed by that agreement rather than the policy.

Section 13 of the *Insurance Contracts Act* (¶17-310) requires the parties to act with the utmost good faith during the making and settling of claims (see ¶17-790). A settlement is unenforceable where one party deliberately conceals material information during the negotiations.

¶17-710 Notice of loss. Notice of loss clauses usually provide that written notice of any loss or other event giving rise to a claim under the policy must be given to the insurer within x number of days of the loss or

18. eg Hawke, FG, *Acting in insurance-related disputes* (1991) 65 LIJ 576; Kirk, G and Niven, D, *How to make an insurance claim*, Melbourne, Consumer Credit Legal Service, 1996.

19. eg *Settlement Wine Company Pty Ltd v National & General Insurance Co Ltd* (1994) 62 SASR 40 at pp 69-70.

event in question, or at least “promptly” or “immediately”. They also usually require written notice to the insurer of any proceedings against the insured. The object of a notice of loss clause is to enable the insurer to investigate the claim promptly and to enable it to commence proceedings to mitigate the loss, for example by way of salvage or by litigation against third parties.

In the language of contract, a notice of loss clause is a condition subsequent to the insurer’s liability on the policy (¶16-070). The burden of proof is on the insurer as the promisor to prove that the condition subsequent has not been satisfied.

Strict interpretation of notice of loss clauses can work against insureds, even if there is no prejudice to the insurer, so sec 54 restricts an insurer relying on a mere technicality to deny an otherwise valid claim: ¶17-640.

¶17-760 Proof of loss. After notification of a claim has been made to the insurer the insured will be required to furnish “satisfactory” proof of loss. A “proof of loss” clause is capable of being a condition precedent (¶16-060) to the right to recover. Whether the proof submitted is satisfactory will depend on the circumstances of the case, although the question will often be: does it enable a reasonable insurer fully to investigate the claim and to decide upon the appropriate action?

Non-compliance with an unreasonable request by an insurer should not prevent recovery. For example, if the insurer tries to compel the insured to give more information than is required under the relevant notice and proofs of claim clauses in the policy, the court should protect the insured. Such conduct by an insurer may also be a breach of the duty to act with the utmost good faith which is implied in every insurance contract by sec 13 of the *Insurance Contracts Act* (¶17-310). Section 54 may also protect the insured (¶17-640).

Onus of proof. The onus is on the insured to prove the loss upon a balance of probabilities. In addition, the insured must prove that the cause of the loss was an event insured against (¶17-780). In comparison, the onus of proof regarding breach of a condition of the policy is less certain. The onus of proving compliance with a condition generally rests on the insured, but there is strong opinion that the insurer should have to prove breach of a condition.

Under sec 54 of the *Insurance Contracts Act* (¶17-640), the onus to prove that an act or omission constituting a breach of warranty or other term of the contract does not cause or contribute to the loss, whether wholly or partly, lies on the insured.

Liability insurance. Some contracts of liability insurance (¶17-050) provide cover for:

- *events which occurred* within the policy period, and allow a claim in respect of those events to be lodged after the insurance has expired; or for
- *claims made* against the insured only during the period of insurance

even though the events giving rise to liability may have occurred before the period of insurance. Because this cover is narrow, the insurer must clearly notify the insured of its operation (a penalty applies for failing to do so) so that the insured can get further cover.

Section 40 provides that the insurer may be liable for claims made after the policy has expired if the circumstances which gave rise to that claim had been notified to the insurer within the policy period.

— *Case example* —

The insured gave its professional liability insurer notice of facts which might have given rise to claims before the policy expired as permitted by sec 40(3). The High Court confirmed that sec 40(3) applies to all “claims made” policies,²⁰ and that the insured was able to make claims for fatalities, personal injuries and property damage outside the policy period.

— *Newcastle City Council v GIO General Ltd*²¹ —

¶17-775 Exclusions. Exclusion or exception clauses form a major part of all insurance policies. The degree of strictness and level of exclusion vary, but cover such matters as are shown in the following examples:

— *Examples* —

“We will not pay for destruction or damage caused or liability incurred while the vehicle is being driven by a person who is under the influence of intoxicating liquor ... if the driver is you ...”²²

“This policy does not cover loss, damage, or liability caused or arising from:
(a) Your wilful or deliberate act ...”²³

— *Case example* —

The professional indemnity insurer of a law firm was held not liable for the firm’s liability to clients caused by the fraud of one of its partners seeking to obtain secret profits and commissions. The claim fell within the policy exclusion which stated that the insurer “shall not indemnify the Assured in respect of any liability ... brought about by the dishonest or fraudulent act or omission of the Assured”. Although the other partners were not aware of the fraud and could not be taken to know of it (¶10-350), they could not claim under the policy. One lesson of this case is that firms should obtain insurance coverage for innocent partners.

— *Switzerland Insurance Australia Ltd v McCann*²⁴ —

20. A “claims made” policy refers to a policy where indemnity is given for losses which are subject to claims made on the insured during the policy period. A “claims made” policy can be contrasted with a “claims made and notified policy”, where cover is limited to claims made and notified to the insurer during the policy period.
21. (1997) 72 ALJR 97.
22. *Annear v GRE Insurance Ltd* (1988) 5 ANZ Insurance Cases ¶60-830; see further Nicholson, KG and Tarr, AA, *Driving under the influence exclusions in motor vehicle policies* (1989) 63 ALJ 20.
23. *Daniel v Accident Insurance Mutual Holdings* (1996) 9 ANZ Insurance Cases ¶61-297 (claim allowed for reckless driving).
24. [1999] NSWCA 310; (1999) 10 ANZ Insurance Cases ¶61-446.

Where an exclusion clause applies (§6-180ff), the insurer is entitled to defeat the claim at common law, even though the policy continues in force. A policy may also provide for a suspension of indemnity where, for example, a house is left without an inhabitant for any period in excess of 60 days.²⁵

The insurer may have the option of deciding whether or not to rely upon an exclusion, although various statutes now restrict the operation of exclusion clauses in the following manner:

- Exclusions and limitations are prescribed where standard cover applies and, where it does not, unusual terms must be brought to the notice of the insured: *Insurance Contracts Act* sec 35, 37 (§17-610).
- Where a contract excludes the insurer's liability because of some act or omission of the insured or a third party, the insurer cannot refuse to pay a claim where this act or omission does not cause or contribute to the loss: *Insurance Contracts Act* sec 54 (§17-640).
- An insurer cannot rely on a provision in an instalment contract of general insurance which limits its liability for non-payment of a premium instalment, unless at least one instalment is unpaid for at least 14 days and, before or at the time the contract is entered into, the insurer clearly informs the insured in writing of the effect of that provision: *Insurance Contracts Act* sec 39.
- An insurer cannot rely on a provision in a contract of insurance which limits or excludes the insurer's liability by reference to a pre-existing defect or imperfection in the insured property, or a pre-existing sickness or disability of the insured, if, when the contract is entered into, the insured is not aware of that defect or sickness: *Insurance Contracts Act* sec 46, 47.
- A claim by a supplier of goods under its product liability or product recall insurance is not affected merely because the supplier provides information to the relevant authorities about goods supplied or proposed to be supplied: *Trade Practices Act 1974* (Cth) sec 65T.²⁶
- In New South Wales, a clause of an insurance contract which limits or excludes an insurer's liability does not apply if the loss was caused or contributed to by factors not mentioned in that clause of the contract, unless in all the circumstances it is not reasonable for the insurer to be bound to indemnify the insured: *Insurance Act 1902* (NSW) sec 18B.

¶17-780 Causation. A loss covered by a contract of insurance must be caused by a risk insured against. Insurance law asks what was the *proximate cause* — or the dominant or effective cause — of the loss. There may be

25. eg *Pryer v Mercantile Mutual Insurance Ltd* [1986] Tas R 84; (1986) 4 ANZ Insurance Cases ¶60-711.

26. Also *Fair Trading Act 1987* (NSW) sec 37; 1999 (Vic) sec 56; 1987 (WA) sec 57; *Consumer Affairs and Fair Trading Act 1990* (NT) sec 40.

more than one proximate cause, and a later cause, closer in time to the loss, does not alter the proximate nature of the earlier cause so long as the earlier cause is within the cover of the insurance policy.²⁷

Injury “caused by accident” in personal accident or disability insurance does not simply mean accidental injury. The injury must be caused by an unexpected and unintended mishap, although that may follow an intentional act.

— *Case example* —

F’s job was to level the sand and cement mixture on which tiles would be laid. He did this by drawing a 3.5 metre long straight edged tool towards himself. At times the task required the exertion of considerable force while he was squatting or bending. After working for 15 years without mishap he suddenly sustained a massive central disc prolapse. There was no pre-existing degenerative condition. The High Court held that the injury had been caused by an accident within the meaning of a disability policy. The cause of the injury was the intensive pressure through the disc system. Although F’s action in levelling the sand and cement mixture had been intentional, the incidental creation of the internal pressure to an extent greater than his disc system could bear had been both unintentional and unexpected.

— *Australian Casualty Co Ltd v Federico*²⁸ —

¶17-790 Fraudulent claims, loss by own act, criminal and illegal acts. The duty of utmost good faith which governs insurance contracts both at common law and under the *Insurance Contracts Act* (¶17-310) is important in relation to claims.

Fraudulent claims. The *Insurance Contracts Act* prevents an insurer from avoiding a contract as a result of a fraudulent claim, although it may refuse to pay the whole of the claim (sec 56). In attempting to strike a balance between insurer and insured, the section seeks to discourage fraud (sec 56(3)), but not to the extent that an insured suffers loss far in excess of the damage the insured’s fraud may have caused the insurer. Section 56 does not detract from sec 60, which allows an insurer to cancel the contract, and it does not detract from the insurer’s ability to avoid the contract for fraudulent non-disclosure or fraudulent misrepresentation (¶17-480).

— *Case example* —

Despite having received a traffic infringement notice showing a blood alcohol concentration of 0.102%, P answered “no” to the question in the claim form which asked “Has the driver ... consumed intoxicating liquor ... ?”. Because the answer in the claim form was false or fraudulent, the insurer had the right to refuse payment of the claim under sec 56. P was also in breach of

27. eg *Switzerland Insurance Australia Ltd v McCann* [1999] NSWCA 310 at [95]; (1999) 10 ANZ Insurance Cases ¶61-446.

28. (1986) 160 CLR 513; (1986) 4 ANZ Insurance Cases ¶60-712; noted (1986) 60 ALJ 478.

the duty of the utmost good faith implied in the insurance contract by sec 13 (¶17-310).

— *Gugliotti v Commercial Union Assurance Company of Australia*²⁹ —

Loss by own act. The basic presumption of insurance is that the insurer agrees to indemnify the insured for losses caused by fortuitous and unexpected events. Therefore the insured will be denied recovery both at common law and under the statutory duty of good faith imposed by sec 13 of the *Insurance Contracts Act 1984* (Cth) (¶17-310) for any act done by the insured with the intention of causing loss under the policy in order to make a claim. The classic example of this is where the insured deliberately sets fire to the insured's own property (such a claim will always be fraudulent).³⁰

The question is not one of public policy or illegality but one of construction — it is clear that it is never intended that a policy should cover a loss deliberately caused by the insured.³¹

Criminal and illegal acts. At common law no one can be permitted to benefit by their own criminal act, or to assert rights which, but for that act, would not have arisen (*ex turpi causa non oritur actio*).³² Where the insured has deliberately committed an unlawful act with unintentional consequences which give rise to an insurance claim, factors such as sec 13 of the *Insurance Contracts Act*, the seriousness of any offence and public interest should be considered, although the claim will not always be defeated.³³ The test seems to be whether the act of the insured is of such an anti-social character that the interests of the public require that the court should decline to enforce the contract.

¶17-800 Arbitration. Clauses in policies making the arbitration of disputes compulsory are valid at common law.³⁴ However, they have been rendered ineffective by sec 43 of the *Insurance Contracts Act*, as well as by legislation in most States and Territories.³⁵ The *Insurance Contracts Act*

29. (1992) 7 ANZ Insurance Cases ¶61-104.

30. But in the case of a policy issued jointly over jointly owned property, arson by policyholder 1 does not prevent recovery on the joint policy by innocent co-insured policyholder 2 for the latter's share of the joint property: *Holmes v GRE Insurance Ltd* (1989) 5 ANZ Insurance Cases ¶60-894 (cf *Matthews' case*, ¶17-420).

31. eg *Clark v NZI Life Ltd* [1991] 2 Qd R 11; (1990) 6 ANZ Insurance Cases ¶60-988 (liability under the life policy was excluded if the insured suicided). The forebear of sec 228 of the *Life Insurance Act 1995* (Cth) overcame the public policy decision in *Beresford v Royal Insurance Ltd* [1938] AC 586 which precluded recovery for death resulting from suicide.

32. An action does not arise from a base cause, ie an illegal contract is void.

33. eg the death of the insured in an accident while driving on the wrong side of the road may have been caused by dangerous and culpable driving, but this did not disentitle a claim by the deceased's estate, as the accident did not amount to a "criminal act" within the meaning of the exclusion in the deceased's personal accident policy: *Australian Aviation Underwriting Pty Ltd v Henry* (1988) 12 NSWLR 121; (1988) 5 ANZ Insurance Cases ¶60-836, noted (1988) 16 ABLR 251.

34. *Scott v Avery* (1856) 5 HL Cas 811; 10 ER 1121; [1843-60] All ER Rep 1; ¶1-443.

35. Commercial arbitration legislation is set out at ¶1-443.

(sec 43(2)) and the State and Territory legislation allow the parties to agree after a dispute has arisen to submit the dispute to arbitration.

¶17-805 Insurance disputes in Small Claims Tribunals.

Insurance disputes which fall within the relevant jurisdictional limits may be heard and settled speedily and cheaply in the Small Claims Tribunals established in all jurisdictions (outlined at ¶7-690—¶7-720). In New South Wales,³⁶ Victoria,³⁷ and Western Australia,³⁸ the tribunal is expressly empowered to hear claims arising under contracts of insurance (other than life insurance in New South Wales and Victoria and workers' compensation and compulsory third party motor vehicle insurance in Western Australia), and insurance claims should fall within the jurisdiction of the relevant tribunals in the other States and Territories.

¶17-810 Insurance industry complaints schemes. The insurance industry responded to criticisms of the difficulties faced by some people in dealing with insurance companies by setting up national complaints schemes to supplement industry dispute resolution services. The Insurance Codes of Practice (¶17-036) require each insurer to have an internal dispute resolution system (IDR) in place. The codes require that if an insurer cannot settle a complaint, it must refer the complaint to a recognised external scheme, as discussed below.

These external schemes apply to consumers and participating insurers. With the exception of the LICs (below), the schemes are funded by the industry, and their services — conciliation and arbitration — are available free of charge to consumers. The insurance schemes are structured as follows:

- The Board of Insurance Enquiries and Complaints Ltd (IEC), an independent company set up in 1993, is the overall governing body.
- *Complaints against general insurers*

The General Insurance Enquiries and Complaints Service is administered by Insurance Enquiries & Complaints Ltd (IEC). The classes of insurance covered include home building; home contents; motor vehicle; travel, sickness and disability; consumer credit; insurance covering personal and domestic property; residential strata title; and some small business insurance.

Consumers are first referred to their insurer's internal dispute resolution (IDR) process, as required by the code. If the dispute remains unresolved, it may then be referred to the scheme for determination. The claims

36. *Consumer Claims Act 1998* (NSW) "consumer claim"; "services".

37. *Small Claims Act 1973* (Vic) sec 2 (amended definition of "small claim", to overcome the decision in *R v Small Claims Tribunal and Dean; Ex parte RACV*

General Insurance Pty Ltd [1981] VR 602). Small claims are heard in VCAT: ¶7-730.

38. *Small Claims Tribunals Act 1974* (WA) sec 4.

review panels determine all disputes except for disputes where fraud is alleged, which are determined by a referee, and non-complex disputes where less than \$3,000 is in dispute, which are determined by an adjudicator. The scheme provides written determinations, which are binding on participating insurers for claims up to \$120,000, and recommend settlements over that amount up to \$290,000. The jurisdiction of the Scheme also includes determination of disputes involving third parties in relation to motor vehicle property damage if the claim does not exceed \$3,000.

- *Complaints against life insurers*

The Financial Industry Complaints Service (FICS) (previously called the Life Insurance Complaints Scheme, going back to 1991), run by the Financial Industry Complaints Service Ltd, deals with complaints in the area of financial services including life industry (and financial planners and the stock exchange). The scheme requires that a consumer first attempt to redress the matter with the insurer. If no resolution is reached then a case manager will investigate, negotiate and conciliate. If no solution is reached the consumer may have the matter referred to the independent panel for arbitration. The panel can make awards of up to \$250,000 — these are binding on the insurer but not the consumer. The panel may arbitrate on medical matters up to \$125,000 and may recommend settlement up to \$250,000. If matters concern \$10,000 or less they will be sent to the adjudicator rather than the panel. The adjudicator's decisions are binding on the company but not the panel. All insurers with a licence to sell life insurance are members of the scheme.

FICS is not funded by insurers, but it is a “user pays” scheme for insurers as it receives its income by charging insurers for complaints received. The scheme is free to consumers.

The Life Insurance Code of Practice is noted at ¶17-036.

- *Complaints against brokers*

The Insurance Brokers' Dispute Facility (IBDF) has been established as part of a national self-regulatory scheme which includes the General Insurance Brokers' Code of Practice. The IBDF has been operative since 1 January 1996. It was developed by the National Insurance Brokers Association (NIBA) and is open to both members and non-members of NIBA. The IBDF can resolve disputes in relation to the following types of policies: motor vehicle (CTP or extended third party property damage policies); home buildings and contents, sickness and accident, consumer credit, travel, personal and domestic property and small business and life policies. Any dispute which is not satisfactorily resolved by the broker's internal dispute resolution process may be referred by the insured to the IBDF conciliation relations manager (CRM). If the dispute is still not resolved to the satisfaction of the insured or insurance broker, the CRM will refer the dispute to the referee.

The referee's powers include ordering the insurance broker to (i) make a payment or refund money up to \$10,000, except in the case of life policies where the order may be for \$50,000; (ii) publish corrective advertising; (iii) name the broker in the referee's annual report; and (iv) recommend to the ISC that the broker's registration be cancelled or suspended. There is no right of appeal under the IBDF in respect of the referee's decision.

Membership of an external dispute resolution arrangement is soon to become a condition of registration for all brokers (by an amendment to the *Insurance (Agents and Brokers) Act 1984*).

The insurance industry has resisted moves for an Insurance Ombudsman (similar to the Australian Banking Industry Ombudsman: ¶16-045) and has instead opted for the complaints panels just noted.

¶17-820 Waiver, election, estoppel. Where an insurer learns of a breach by the insured of a condition of the policy the insurer may in theory elect to:³⁹

- (1) waive (forgive) the breach, thus affirming the contract and destroying any right to sue for damages (in which case it could be estopped from later resiling from that position);
- (2) affirm the contract and seek damages for breach;
- (3) accept the breach (repudiation), treat the contract as at an end and maintain an action for damages in respect of its loss.

However, the insurer's rights may be restricted by legislation.⁴⁰ (In any event, it would probably be entitled to nominal damages only since it is unlikely to have suffered loss.)

CLAIMS — MEASUREMENT OF LOSS _____

Computation of loss	¶17-830
Reinstatement	¶17-840
Under-insurance	¶17-850
Ex gratia payments/excess	¶17-870
"Double" or "other" insurance	¶17-900
Contribution	¶17-910
Subrogation	¶17-920

39. As in contract law: ¶6-380ff.

40. eg *Instruments Act 1958* (Vic) sec 27;
Insurance Act 1902 (NSW) sec 18;

Insurance Contracts Act 1984 (Cth)
sec 54 (¶17-640).

¶17-830 Computation of loss. The indemnity principle (¶17-260) means that the insured should be compensated for the loss (subject to the maximum sum insured under the contract) but not make a profit. Working out the loss can give rise to insurance disputes, sometimes added to by an absence of detailed records and realistic valuations.

In the case of a *total loss of goods* (total loss includes the situation where the insured property is so damaged as “to cease to be a thing of the kind insured”⁴¹), the measure of the insured’s loss will be the property’s market value at the time and place of loss, ie its second hand or resale value.

— *Case example* —

Machinery and plant in a commercial car washing and car detailing business were insured against fire for \$44,000. Following a fire, a claim was lodged which included \$35,000 for the automatic washer/dryer. The trial judge, confirmed on appeal, applied the “market value” test for an equivalent machine and attributed \$15,000 to this item, plus \$7,000 for freight and installation plus interest and rejected the insurer’s valuation of between \$2,000 and \$5,000: “An insurer takes an insured’s business as he finds it.”

— *Fire & All Risks Insurance Co Ltd v Rousianos*⁴² —

However, the principle of indemnity is contractual and, in calculating loss, one must always start with the policy itself. Policies often provide for replacement value to represent the measure of loss (ie a “new for old” policy) (¶17-290), in particular policies covering plant and equipment or personal property such as furniture and jewellery.

In the case of *total loss of real property*, the measure of loss is likely to be the cost of reinstatement (¶17-840), at least where the insured wishes to continue to use the property, even though it may be more than market value (subject of course to the limit specified in the policy), or where the property has historic or special features. However, it is the value of the property *to the insured* that is to be measured and therefore where the insured has had the property on the market for sale at a stipulated price, the measure of the loss is likely to be that stipulated price (less site value).

In the case of *partial loss of goods or real property* the measure of indemnity will be the cost of repair.

The option to reinstate, repair or replace the insured property is often reserved to the insurer in the policy. The insurer must pay money (whether the market or replacement cost) if that option is not reserved. The option to reinstate and the option to pay may not be mutually exclusive. An option to

41. *Halsbury’s Laws of England* (4th ed reissue, 1994), Vol 25, para 282. A car, for example, may be so badly damaged as to be uneconomical to repair and may therefore be “written off” as a total loss.

42. (1989) 19 NSWLR 57; (1989) 5 ANZ Insurance Cases ¶60-909.

reinstate must be exercised within a reasonable time, unless a particular time is specified, and once an election is made it cannot be withdrawn.

Life and accident policies. The sum specified in the policy determines the amount recoverable under a life policy. In the case of accident policies the economic loss sustained is determined by reference to medical bills, lost income, amounts set in the policy for specified injuries and, in the case of residual injuries, the levels of damages awarded by the courts.

Legal liability policies. The amount recoverable by the insured is the amount of the insured's liability in law to the third party, subject to any limit specified in the policy.

Valued policies. Where the insured sustains a total loss under a valued policy, the amount recoverable is that specified in the policy. This is so regardless of whether the loss sustained by the insured is greater or less than that amount (and is thus an exception to the indemnity principle: see ¶17-290). However, where there is only a partial loss the amount recoverable will, in the absence of an average clause, be computed by reference to the formula:

$$\frac{(\text{Value before loss} - \text{Value after loss})}{\text{Value before loss}} \times \text{Value stated on policy}$$

— *Case example* —

The insured had effected a valued policy in respect of certain buildings, the agreed value of them being £106,850. There was a partial loss and the insurer established that the market value of the damaged premises had in fact been only £18,000 and that its value after the fire was £12,600. *Morris J* applied the above formula to give the insured £32,055.

— *Elcock v Thompson*⁴³ —

¶17-840 Reinstatement. The policy may give the insurer the choice of repairing or reinstating the damaged property instead of paying compensation by way of indemnity (¶17-260). Reinstatement of property usually means reinstatement to its condition immediately before the damage occurred. Policies often provide that reinstatement will be to “a condition equal to but not better or more extensive than the condition when new”. That does not mean that a reinstated building must conform precisely in appearance, structure and configuration with the original building, although there should be “equality” in the sense of size, quality, amenities, space, etc.⁴⁴

The indemnity policy may provide for:

43. [1949] 2 KB 755; [1949] 2 All ER 381. The ALRC saw valued policies as reducing the costs associated with insurance, and recommended no action: ALRC, *Insurance Contracts* (1982), *op cit*, para 133.

44. *D'Aloia v Colonial Mutual General Insurance Co Ltd* (1990) 6 ANZ Insurance Cases ¶61-009.

- reinstatement by consent or by the conferring of an option for the discharge of insurance liability by reinstatement, or
- indemnity based on the cost of reinstatement.

Even if the insured property is further damaged in the course of reinstatement — such as by a second fire — the insurer must complete the reinstatement.⁴⁵

An insurer of damaged property may also be required under statute⁴⁶ to expend the insurance money (ie the amount otherwise payable to the insured), as far as it will go, on reinstating the property where requested to do so by a “person interested” in the property, eg a mortgagee, tenant, purchaser under a binding contract of sale and a person in possession.

¶17-850 Under-insurance. Inflation and rising property values can easily lead to under-insurance, the situation where the sum insured is less than the value of the property insured. Insurers lose premium income, and only those insureds who insure for full value are fully covered.

Insurers have relied on two contractual methods to protect themselves against under-insurance: the warranty of value and the principle of average.⁴⁷

Warranty of value. At common law breach of a warranty of value — perhaps by means of a basis clause (¶17-090) — provides grounds for the insurer to avoid the policy if the stated value is inaccurate at the time.

Under sec 54 of the *Insurance Contracts Act* (¶17-640), a breach of such a warranty will only allow the insurer to reduce the amount of a claim by that sum which fairly represents the extent to which its interests have been prejudiced by breach (in effect the amount of premium income lost because of the under-valuation). The insurer may cancel the contract, without affecting any prior claim (sec 60) (¶17-680). A valuation in a proposal is a representation only and not a warranty (sec 24) (¶17-650). If the valuation is wrong, there will not be a misrepresentation if the insured reasonably believes it to be true (sec 26(1)) (¶17-450).

The principle of average. The second solution to under-insurance has been to use “average” clauses. A typical average clause reads as follows:

45. *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 9 ANZ Insurance Cases ¶61-348 (High Court); (1997) 187 CLR 384.

46. *Fires Prevention (Metropolis) Act 1774* (Imp) sec 83; *Property Law Act 1974* (Qld) sec 58; *Conveyancing and Law of Property Act 1884* (Tas) sec 90E. Sec 83 of the Imperial Act only applies in relation to State or Territory insurance (ie insurance by the State or Territory as

insurer) in South Australia, Western Australia and the Northern Territory. It does not apply in NSW or Victoria and was repealed in so far as it formed part of Commonwealth insurance law by sec 3 of the *Insurance Contracts Act*.

47. Undervaluation may also be analysed as non-disclosure: *CIC Insurance Ltd v Barwon Region Water Authority* (1999) 10 ANZ Insurance Cases ¶61-425 at p 74,771.

“If the value of the property insured of any item shall at the time of the loss be of greater value than the sum insured on such item, then the insured shall be considered as being his own insurer for the difference and shall bear a rateable proportion of the loss accordingly.”

The average formula can be expressed as follows:

$$\frac{\text{Policy value}}{\text{Value of subject matter}} \times \text{Amount of loss}$$

The insured becomes a self-insurer not merely for the shortfall in the policy over the loss, but for an additional amount which equals that proportion which the shortfall bears to the total value. Consequently, where average applies, an insured will recover less than the amount of the actual loss.⁴⁸

Under sec 44 of the *Insurance Contracts Act*:

- An insurer cannot rely on an average provision unless, before or at the time the contract is entered into, it clearly informs the insured in writing of the nature and effect of the provision (sec 44(1)).
- In the case of buildings and/or contents insurance, where the building is used primarily as a residence for the insured and/or those with whom the insured has a family or personal relationship, an average provision will be ineffective where the sum insured is 80% or more of the value of the insured property at the date of the contract (sec 44(2), (4)).
- Where the sum insured in such a contract is less than 80% of the value, an average clause will operate to allow the insurer to reduce the claim, but the amount of reduction will be calculated by reference to a formula based on the difference between 80% of the value of the property (at the time the contract is entered into) and the sum insured (sec 44(3) and (4)).

Examples

- (1) B insures the contents of his residence, valued at \$15,000, for \$10,000. A stereo worth \$1,000 is stolen. If the contract contains an average clause, by virtue of sec 44 the insurer will pay:

$$\frac{10,000 \times 1,000}{8/10 \times 15,000} = \$833.33 \text{ (sec 44(3)).}$$

(But for sec 44, the insurer would pay only \$666.66.)

- (2) If the contents are insured for \$12,000, the insured will be entitled to the full amount of the loss (sec 44(2)).⁴⁹
-

48. The distinction between the two “solutions” is that breach of the warranty of value entitles the insurer to avoid the policy and thereby defeat the whole claim,

whereas reliance on an average clause only reduces the claim.

49. ALRC, *Insurance Contracts* (1982), *op cit*, para 288.

¶17-870 Ex gratia payments/excess. Some insurers offer ex gratia payments when they dispute the insured's right to recover under the policy. Such payments do not amount to an admission of liability, but when made the insured is required to release the insurer from all liability under the policy. Ex gratia payments can avoid costly litigation and can insulate an insurer from potentially adverse publicity.

Excess clauses, or "deductibles", are common in houseowner's/householder's, motor and third party policies, among others. An excess clause provides that the insured will bear the first part of any loss, expressed either as an amount of money or as a stated percentage of the loss.

¶17-900 "Double" or "other" insurance. More than one insurance policy can be taken out over the same subject matter. A situation of double insurance exists where the same insured enters into co-existing contracts of insurance with independent insurers in respect of the same risk, such as overlapping compulsory third party insurance and employer's liability insurance.⁵⁰ The nature of the insurance (ie replacement basis or indemnity basis) need not be identical. The first policy may not cover the insured's potential loss in full or the risk covered may be limited. In the case of general insurance, the insured cannot recover more than the amount of the actual loss (¶17-260), regardless of the number of policies held.

Policies often contain a "double" or "other" insurance clause, which provides that unless the insured notifies the insurer, before any loss occurs, of all existing and subsequently effected insurances in relation to the same subject matter, all benefit under the policy is forfeited.

Section 45 of the *Insurance Contracts Act* renders such "other insurance" clauses void except in an insurance contract which is a genuine excess contract, or where any other insurance is compulsory, eg workers' compensation or third party motor vehicle insurance.⁵¹

¶17-910 Contribution. Where there is double insurance (¶17-900) and one insurer indemnifies the insured in whole or in part, that insurer as a matter of justice is entitled to claim a contribution from the other insurer(s) at common law or in equity.⁵² The right to contribution exists where the same property or liability is covered against the same risk under more than one legally enforceable contract of insurance.

The common law position is largely confirmed by sec 76 of the *Insurance Contracts Act*. The position may be complicated, however, by the fact that

50. *State Government Insurance Commission v Switzerland Insurance Australia Ltd* (1995) 8 ANZ Insurance Cases ¶61-267.

51. Further, sec 18 of the *Insurance Act 1902* (NSW) and sec 27 of the *Instruments Act 1958* (Vic) may apply to give some relief

to insureds where they fail to notify an insurer of other insurance.

52. eg *HIH Casualty & General Insurance Ltd v FAI General Insurance Co Ltd* (1997) 9 ANZ Insurance Cases ¶61-358; ¶61-376.

indemnity insurance policies often contain clauses limiting the insurer's liability where there is double insurance.

Where such clauses exist, the courts will, at common law, endeavour to uphold the legitimate expectations of the insured:

- The effect of a "rateable proportion" clause is to force the insured to recover the appropriate proportion from each insurer, although if one insurer does choose to pay the claim in full it will not be prevented from claiming contribution.
- If both policies contain a "no liability at all" clause, a commonsense approach will be adopted and both insurers will be liable, but the proportions of liability will depend on any rateable proportion clause.
- If one policy contains a "rateable proportion" clause and the other an "excess" clause, the insurer under the latter policy will only be liable if there is an excess, ie if the loss is greater than the sum insured under the first policy (ignoring the rateable proportion clause).

Section 45 of the *Insurance Contracts Act* makes such clauses limiting or excluding an insurer's liability where there is other insurance void, except in a genuine excess policy or where such other insurance is compulsory, eg workers' compensation or third party insurance. As a result, an insurer can more easily establish that liability in respect of the same loss exists under another policy.

¶17-920 Subrogation. In addition to its right of contribution (¶17-910), an insurer is able to "stand in the shoes" of the insured and is subrogated to all the insured's rights under the policy against the person causing the loss.⁵³ Arising automatically by operation of law, the insurer's right to subrogation applies to all indemnity policies. Subrogation does not apply to non-indemnity policies such as those for life, sickness or personal accident.

Subrogation can be excluded in the policy,⁵⁴ and it has been restricted by the *Insurance Contracts Act 1984* (Cth).

Section 65 restricts the insurer's right of subrogation where the insured cannot reasonably be expected to exercise legal rights because of a family or other personal relationship with the third party wrongdoer (sec 65(1)(c)(i)). It is also restricted where a person was using the insured's vehicle with the insured's consent at the time of the loss (sec 65(1)(c)(ii)). For example, an insurer cannot be subrogated to the rights of its insured (a car dealer) against a third party "test driving" the insured car with the car dealer's consent.⁵⁵

Section 65(3) provides that where the third party is not insured, the insurer does not have the right to be subrogated to the rights of the insured.

53. Compare the right of creditors to be subrogated to the trustee's right to reimbursement from trust property: ¶9-900.

54. eg motor vehicle comprehensive policies often exclude the insurer's right to

subrogation in relation to drivers using the vehicle with the consent of the insured.

55. eg *Lennox Motors Pty Ltd v Pastrello* (1991) 101 FLR 405; (1991) 6 ANZ Insurance Cases ¶61-033.

The insurer does have the right to subrogation if the conduct of the third party that gave rise to the loss:

- occurred in the course of employment (sec 65(2)(a)), or
- was serious or wilful misconduct (sec 65(2)(b)).

— *Case example: sec 65(2)(b)* —

After having worked a 17-hour day, an employee went to a hotel and consumed two pies and about 12 beers. He then used his employer's truck (with a trailer attached) to drive to the nearby motel where he was staying, but he fell asleep at the wheel and ran off the road. The accident caused about \$17,000 damage to the trailer. His breathalyser reading was 0.11. The employer claimed on its insurance and was indemnified for the loss. The insurer then sued the employee in the employer's name to recover the loss, and was successful as the loss was caused by the "serious ... misconduct" of the employee under sec 65(2)(b).

— *Boral Resources (Queensland) Pty Ltd v Pyke*⁵⁶ —

Also if the third party is uninsured in respect of liability to the insured, the insurer has no right of subrogation (sec 65(3)).

If the third party *is* insured, the insurer cannot recover more than the amount which the third party can recover under the third party's own insurance (sec 65(4)).

Suing in insured's name. Once it has fully indemnified the insured, the insurer can enforce its right of subrogation (subject to any of the statutory provisions discussed above). However, unless the insured has assigned rights against the third party to the insurer, it must sue in the insured's name.⁵⁷

Surplus moneys. At common law, where subrogation is allowed, any surplus recovered by the insurer or insured over and above the indemnity already paid belongs to the insured. Section 67 of the *Insurance Contracts Act* provides that the insured may not recover more than the amount of the loss (unless the contract provides otherwise) and the insurer is entitled to retain any amount it recovers in excess of the insured's loss.

"Compromise clause". An insured is under a duty not to prejudice the insurer's right of subrogation after a loss has occurred. Policies often state that any settlement or compromise without the insurer's consent deprives the insured of all benefit under the policy. Section 68 states that an insurer cannot rely on such a provision unless the insurer clearly informed the insured in writing of the effect of the provision at or before the making of the contract. If the insured does compromise its rights against a third party, the insured will be liable in damages for any loss to the insurer, unless protected by sec 68. The amount recoverable by the insurer will usually be the amount of any indemnity already paid to the insured.

56. [1992] 2 Qd R 25.

57. The policy will usually provide, however, that the insured will do everything to

assist the insurer, including assigning the insured's rights.

Glossary

Words in bold type within definitions are defined elsewhere in the glossary. Foreign words are italicised.

ab initio. From the beginning.

action. A civil proceeding which can be commenced by either a writ or a summons or other means, according to the rules of the court. It usually refers to a proceeding brought to recover damages, as distinct from a suit in **equity** seeking specific performance or an injunction.

adduce. To bring forward in argument; cite as an example or proof.

adeem/ademption. Extinguish/extinction of a legacy on alteration or disposal of the subject matter.

agent. One who acts on behalf of another, the **principal**, with the object of bringing the principal into legal relationship with a third party.

animus furandi. The intention of stealing.

annuity. Series of payments made regularly in return for a capital sum.

appellant. One who appeals.

appellate. Relating to an appeal against a decision by a lower court or authority, as in appellate jurisdiction of a court.

arraign. To call a prisoner to the bar of the court by name, to read to him the substance of the **indictment**, and to ask him whether he pleads guilty or not guilty.

assessor. Person who estimates the value and causes of losses, usually on behalf of an insurance company.

assign/assignee/assignor. To give or grant another person one's rights, usually contract rights. The one who assigns is the assignor; the one to whom they are assigned is the assignee.

auction. Public sale of property where the goods are sold to the highest bidder.

authorisation. Procedure available for certain business conduct whereby, if the Australian Competition and Consumer Commission is satisfied that the stated degree of public benefit results, the conduct will be granted immunity from the operation of the *Trade Practices Act*.

autrefois acquit/convict. (Formerly acquitted/convicted.) A special **plea** in bar to a criminal prosecution that the prisoner has already been tried for the same offence before a court of competent jurisdiction and has been acquitted/convicted.

avoid. To set aside or vacate; to make null and void.

bailee/bailment. The person to whom goods are delivered for safekeeping, repairs, etc/the act of so delivering or entrusting one's goods to another person.

abi

- basis clause.** Clause in a **proposal form** whereby the applicant agrees that the statements contained in the proposal shall form the basis of the contract between the applicant and the **insurer**.
- beneficiary.** The person who benefits under the **fiduciary** relationship of a **trust**; generally referred to as the *cestui que trust*.
- bill.** A letter or writing; (1) A parliamentary measure which, on receiving the royal assent, becomes an Act of Parliament; (2) a document by which proceedings were formerly commenced, eg a Bill in Chancery; (3) a "bill of exchange".
- bill of lading.** A document approximating a delivery note passed to the shipper of goods setting out details of the goods. The buyer obtains the goods by presentation of the buyer's copy to the shipper.
- brokerage.** A broker's commission.
- cif** (cost, insurance, freight). A contract for the sale of goods where the seller's duties include shipping the goods named in the contract, procuring on shipment a contract of affreightment, and effecting insurance.
- capacity.** Legal entitlement to enter into a contract.
- capias.** A type of **writ**, generally directed to the sheriff, ordering the arrest of the person named therein. (Latin: that you take.)
- caveat.** A document restraining dealings; beware, as in *caveat emptor*. (Latin: let the buyer beware.)
- certiorari.** An order by a superior court to an inferior court to submit its official record of a decision for review, where a proceeding contrary to law has been alleged.
- cestui que trust.** A person for whom another holds in **trust** property or an interest in property; **beneficiary**.
- champerty.** A type of illegal agreement in which a person who has no interest in civil proceedings helps someone else to prosecute, etc, and takes a share of the winnings as reward.
- charge.** A security for the payment of a debt giving the creditor the right to payment from a specific fund or property, which is "charged" with the debt. The **mortgagee** of Torrens title land receives a statutory charge.
- charterparty.** A contract by which an entire ship or a part thereof is let to a charterer for the carriage of goods.
- chose in action.** Right of action to recover a debt or a possession. (French: *chose* — thing.) The term is often used to describe such items as book debts, shares and other securities, contractual rights, bills of exchange, policies of insurance and similar interests.
- claim.** The assertion of a right; demand for payment under a **policy**.
- class action.** A legal action enabling representatives of a class of persons, named or unnamed, to sue on behalf of the class in respect of a **claim** in which the class has a common interest.
- clearance.** (1) Procedure previously available whereby, if the former Trade Practices Commission was satisfied that certain conduct did not result in a substantial lessening of competition, the conduct was granted immunity. (2) A certificate by the Customs to the effect that a ship has complied with the Customs requirements and is at liberty to put to sea.

commission. Payment to an **agent**, usually expressed as a percentage of price or **premium** or the **sum insured**.

committal. The sending of a person to prison, generally for a short period, or temporary purpose, eg for contempt of court.

committal proceedings. Proceedings to determine whether there is sufficient evidence to put a person on trial for an **indictable offence**.

common law. A branch of the law which depended on the customs of the country and was unwritten. It is distinguished from statute law (laid down by Acts of Parliament), civil law (the law of Rome), special law (the law of special courts such as ecclesiastical courts), and **equity**.

common mistake. A mistake shared or held in common by both parties to a contract.

competition. Rivalry between firms manifesting itself in various ways and resulting from a sensitivity to the activity of others in the same **market**.

compromise. Parties agreeing to settle their differences rather than demanding in full their strict contractual rights.

condition. (1) A provision that some right will depend on the happening of some event. A condition precedent delays the vesting of the right until the event has taken place; a condition subsequent destroys the right when the event has taken place. (2) A stipulation in a contract which cannot be broken without giving the other party the right to repudiate the contract; contrasted with **warranty**, which is a collateral agreement, one which can only give rise to a claim for damages.

consideration. A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.

contra bonos mores. Against good morals.

contra proferentem. Abbreviated form of the Latin phrase *verba chartarum fortius accipiuntur contra proferentem*: the words of deeds are to be interpreted most strongly against him who uses them.

contract of adhesion. Standard form “take it or leave it” contract.

contribution. Doctrine under which all **insurers** who have insured the same risk contribute proportionately to the loss.

construe/construction. Interpret, translate, give meaning to/the interpretation of a document, phrase, etc in order to give it legal meaning.

conversion. A dealing with another person’s property without authority in such a way as to deny the true owner’s rights over it.

corpus. (1) The capital of a fund, as contrasted with the income. (2) The **trust** property (Latin: body); older cases referred to it as the trust *res* (Latin: matter or thing).

covenant/covenantor/covenantee. An agreement contained in deed/the party who carries the burden of the covenant/the party who derives the benefit.

cover note. An interim contract of insurance pending the arrangement of full, ie long term, cover.

deed. Written document signed by the parties, sealed and delivered, setting out in full the agreement between them.

de facto. In fact, actually.

com

defendant (D). The person being sued, the one against whom a civil action is brought; often (but not always) the second party named in citing a case.

delegated legislation. A law passed by a subordinate authority rather than Parliament.

demurrage. (1) The detention of a ship beyond the number of days — called lay days — allowing for loading or unloading, and (2) the sum fixed by the contract of affreightment (the **charterparty**) as payable to the shipowner for such detention.

detinue. The action for which the remedy is the specific return of goods wrongfully detained or their value, with or without a claim for hire or for damages for detention.

dicta — see *obiter dictum*. Expressions of opinion by a judge not strictly necessary to the *ratio decidendi* or principle of the judge's decision.

discretionary trust. A trust where the trustee is given the discretion by the settlor of determining from a range of beneficiaries or objects named which one or ones should receive the particular benefit (such as income from trust property) at any particular moment of time and in what proportions.

distinguish. Find a difference between two or more cases; what a judge does when finding a reason for departing from a previous decision on cases with similar facts.

distringas. (Formerly) a writ ordering a sheriff to seize goods and chattels of another person for a certain purpose. (Latin: that you distrain.)

ejusdem generis. Where general words follow particular words, the general words are limited to the same kind or class as the particular words.

election. Choice.

elegit. Former writ of execution whereby lands of judgment debtor were held by judgment creditor until satisfaction of the debt. (Latin: he has chosen.)

embezzlement. The felony which consisted of the conversion to his own use by a clerk or servant of property received by him on behalf of his master.

endowment. Type of life insurance in which a sum is paid after a fixed period or upon death before the period is completed.

enjoy. To be entitled to the use or benefit of a thing; "quiet enjoyment" is undisturbed possession.

equity. System of jurisprudence administered by the Court of Chancery, once distinct from the common law courts and following different rules, but now incorporated into a single system.

estoppel. That which precludes or stops a person from setting up certain facts or from taking up a certain position because the person's previous words or conduct are inconsistent with it.

excess. That part of the loss which the insured must bear. Usually recoverable from any third party who, in law, caused the loss.

exclusionary provision. Defined term under the *Trade Practices Act* (including primary boycott) consisting of agreement between competitors affecting availability of goods or services to or from others — prohibited by sec 45.

executor. The title given to a male person appointed in a will to administer its terms. The female equivalent is referred to as an *executrix*.

executory. (Contract) not completed, still to be performed.

ex gratia. Voluntarily.

ex parte. An application in a judicial hearing made by one party in the absence of the other.

ex turpi causa non oritur actio. An action does not arise from a base cause (ie an illegal contract is **void**).

express. Stated; contrasted with “implied”.

fob (free on board). A price quoted for goods including placing them on board ship. Delivery is complete when the goods are on board.

felony. At **common law**, every species of crime, a conviction for which occasioned the forfeiture of the lands or goods of the offender, and the penalty for which was death (except petty **larceny** and mayhem). The term is still used generally for serious crimes such as murder and armed robbery although the consequences which followed conviction at **common law** no longer apply.

fiduciary. Relationship of one person to another, where the former is bound to exercise rights and powers in good faith for the benefit of the latter — eg as between **trustee** and **beneficiary**; the person who owes such a duty of good faith.

fiat facias (fi fa). Writ of execution addressed to sheriff authorising him to seize and sell goods of the judgment debtor and apply the proceeds in satisfaction of the debt. (Latin: that you cause to be done.)

firm. Persons who have entered into **partnership** with one another; a looser term than “company” for an association of persons in business.

force majeure clause. A contractual clause excluding liability where failure to perform is caused by events (either natural or human) outside the control of the parties (French: superior force.)

forcing. Conduct or agreement whereby seller makes the supply of the desired product conditional upon accepting another product or products. Third-line forcing is where the buyer is required to take another party’s product as part of the bargain.

franchise. Contractual right of franchisee (retailer) to sell goods or services under franchisor’s (supplier’s) trademark or business name in a defined area with no **competition** from other sellers of supplier’s goods or services.

fraud. Criminal deception; gaining an unjust advantage by making a false representation knowingly, or without belief in its truth, or recklessly, careless whether it be true or false.

frustration. The discharge of a contract rendered impossible of performance by external causes beyond the contemplation of the parties.

held. Found, decided by a court; the words used in reporting the court’s decision.

hypothecation. In general terms, a **charge** over property. More technically, a form of security over property for repayment of a loan taken out to acquire the property, where the property is held by the debtor and not delivered to the lender.

ibid. In the same place; short for Latin *ibidem*, and used in footnotes to indicate that the reference is the same as in the footnote immediately above. If other references intervene, *loc cit* or *op cit* may be used.

in personam. An act, proceeding or right relating to a specific person (contrasted with *in rem*).

exg

in rem. An act, proceeding or right relating to the world at large; a right of property. (Latin: *res* — a thing or matter.)

in toto. Entirely, as a whole.

in transitu. In the course of transit.

inadmissible (evidence). Facts which are not allowed to be presented before a court, eg in criminal law, evidence of previous crimes or “hearsay” evidence. Some authorities, eg Strata Title Boards, are allowed by statute to listen to any available arguments or facts.

indebitatus assumpsit. Being indebted, he promised or undertook.

indemnity. The protection provided by a contract of insurance.

indictable offences. The more serious crimes triable by judge and jury in the Crown Court.

indictment. A written accusation of one or more persons of a crime, at the suit of the Queen (indicated by “R” for “Regina”), formerly presented on oath by a grand jury.

indorsement. A writing on the back of an **instrument**. Indorsement is a mode of transference of cheques and payment orders, bills of exchange, bills of lading, etc, consisting of the signature of the person to whom the instrument is payable on the back of the instrument and delivery of the transferee (called an indorsement in blank).

information. A pleading; a step by which certain civil and criminal proceedings are commenced.

instrument. A legal document. Examples in land law, for instance, are conveyance, transfer, mortgage, lease.

insurable interest. The benefit which a person derives and the detriment the person would incur if the subject matter of a contract of assurance, or insurance, were to be damaged or destroyed.

insurance policy. Contract of insurance.

insured. The person covered or protected by an **insurance policy**.

insurer. The company (or Lloyd’s underwriter) who accepts the risk and thus contracts to provide the cover.

inter alia. Among other things (Latin).

inter se. Between themselves (Latin); eg a question as to the limits *inter se* of the constitutional powers of the Commonwealth and a State refers to their respective powers.

inter vivos. As in gift *inter vivos* — a gift made during the donor’s lifetime (Latin: between the living).

interest. Right or entitlement. The person who has an interest in something objectively stands to gain or lose by whatever affects it.

interrogatories. A party to an **action** may apply to a Master by **summons** or by notice under the summons for directions for an order giving that party leave to serve interrogatories on any other party, and requiring the other party to answer them on affidavit.

intestate. Without having left a valid will, or having left a will which does not dispose entirely of one's property.

invitation to treat. The preliminary declaration or advertisement which precedes the formal offer to enter into a contract.

joint. Together, both, all; contrasted with "several".

joint and several liability. A legal obligation entered into by two or more persons jointly and severally (individually). Each is liable individually, and all are liable jointly. The other party has the option to sue one or more individually or jointly.

knock for knock agreement. An agreement between two insurance companies under which each agrees to indemnify the person insured with them although he is entitled to have his damages met by the other company because the damage was caused through the negligence of the person insured with that other company.

laches. Unreasonable delay.

larceny. To take, without the consent of the owner, fraudulently and with the intention of permanently depriving the owner of it, and without a claim made in good faith, and carry away, property belonging to another which is capable of being stolen.

lien. The right to hold the property of another as security for the performance of an obligation.

life assured. The person whose life is assured. This person may not be the party who has taken out the cover and who is the **insured** or **beneficiary** under the **policy**.

locus. Place (Latin).

loc cit. In the place already quoted from.

locus standi. "A place for standing", from which to sue. A person who has *locus standi* before a particular tribunal has the right to commence legal proceedings within its jurisdiction and appear before it.

mandamus. An order or writ commanding a person who has a public duty to perform it. (Latin: we command.)

market. Sphere of commercial activity, generally defined by reference to geographic, product, functional, time and other demand or supply characteristics.

market-sharing. Agreement by competitors or potential competitors not to compete within a **market** by reference to the whole market or one or more characteristics, eg area, product, accounts, etc.

maturity. The end of the term of a **policy** of insurance.

mens rea. Guilty mind; evil intention or knowledge of the wrongfulness of an act.

merger. A combination of two companies or their operations so that the two cease to be separately controlled. The term is not defined but is commonly used to refer to the conduct described in sec 50 of the *Trade Practices Act*.

misdemeanour. An **indictable offence**; the least serious level of criminal offence at **common law**.

monopolist. A seller of all or virtually all of the products in a particular **market**.

mortgagee. The person to whom property is mortgaged; the lender of the mortgage amount.

int

mortgagor. The person who mortgages his property as security for the mortgage debt; the borrower.

nemo dat quod non habet. A person cannot pass to another a better title to a possession than he himself has. (Latin: no one gives what he does not have.)

non-discretionary trust. A **trust** where the **trustee** is not required to exercise any discretion as to which **beneficiary** should receive trust property and in what proportion or amount; for example, a declaration of trust for the benefit of X and Y equally.

non est factum. It is not my **deed** or **action**.

notification. Procedure available for certain types of exclusive dealing conduct which gives the party notifying immunity from the *Trade Practices Act* until and unless the Australian Competition and Consumer Commission decides otherwise on **competition** and public benefit grounds.

novation. A three-party agreement where a contract between two parties is rescinded, and a new contract on the same terms made between one of them and a third party.

obiter dictum (pl *dicta*). A judicial expression of opinion on a matter of law, not essential to the decision, and therefore not of binding authority.

offeree. The one to whom an offer is made, who has the power of acceptance.

offeror. The one who makes an offer.

op cit. In the work already cited.

ouster or privative clause. A clause in legislation seeking to exclude or restrict judicial review concerning that legislation.

paid-up policy. A **policy** of life assurance where no further **premiums** are payable but where the policy continues in force.

parol. Oral or verbal.

parol evidence rule. The rule of evidence which prohibits any party to a written contract from adducing verbal evidence to either contradict, vary, add to, or subtract from its terms.

partnership. The relation which subsists between persons carrying on business in common with a view of profit.

per. Through or by; term used to indicate which judge was speaking when the decision of the court was delivered.

per se. By itself, taken alone.

plaintiff (P). The moving party, the one who brings an **action** against another; usually (but not always) named first in the citation of a case.

plea. The reply to a "plaint"; a mode of defence in an **action** of law.

plead. To make a plea.

pledge. The transfer of the possession (but not ownership) of a chattel as security for the payment of a debt or performance of an obligation.

policy. The document stating the terms and thus providing evidence of an insurance contract.

policy holder. The person owning a **policy** and paying the **premiums**; usually the **insured**.

precedent. A judgment or decision of a court of law cited as an authority for deciding a similar set of facts; a case which serves as an authority for the legal principle embodied in its decision.

premium. The consideration (price) payable for a contract of insurance.

price discrimination. Giving different terms as to price, etc to different persons for the same goods.

prima facie. On the face of it; at the first appearance.

primary boycott. Agreement between competitors not to deal with a third party.

principal. The person on whose behalf an **agent** acts.

principle. The ethical or conceptual rule which underlies a set of diverse decisions.

privity. Privacy, isolation; the restriction of a contract to those who are parties to the agreement.

promisor/promisee. The one who makes a promise/the one to whom the promise is made.

proposal form. Application form for insurance; questionnaire to be completed by applicants when applying for insurance cover.

pro rata. Proportionally.

pro tanto. To such extent.

qua. In the capacity of, as.

quantum. Quantity.

quantum meruit. Reasonable value. (Latin: as much as he has earned.)

quasi. Like, corresponding to. (Latin: as if.)

qui facit per alium facit per se. He who acts through an **agent** acts himself.

quid pro quo. One thing in return for another; a **consideration**.

quorum. A fixed number of members of any body, society, etc whose presence is necessary for the valid transaction of business.

ratio decidendi. Statement of law essential to the decision in the particular case; the **principle**.

recognisance. An obligation acknowledged and recorded before a court.

reinsurance. A contract whereby an **insurer** insures with a second insurer the risks the first insurer has already provided cover for.

release. The giving up, discharge, or renunciation of rights or claims against another. When **trustees** or **executors** have wound up an estate they usually require a release from the persons beneficially entitled before handing over or dividing it, in order to clear themselves of responsibility. A release may take the form of a **covenant** not to sue.

remedy. Means of achieving one's rights; covers money damages, decree of specific performance, etc.

representee. The one to whom a representation or claim about a quality of a thing is made.

representor. The one who makes a representation.

pre

- res extincta*. The thing has been done away with: eg where people contract about a cargo which is already lost at sea.
- rescind/rescission**. Put aside, undo, cancel/the act of rescinding.
- respondent**. A person against whom a petition is presented, a **summons** issued, or an appeal brought.
- restitutio in integrum*. Restoration to completeness, in full.
- risk**. The fortuitous event specified in an insurance **policy** in respect of which protection is provided.
- secondary boycott**. Agreement between persons to bring pressure on another person not to deal with a third person.
- settlor**. The person who causes the **trust** relationship to come into being; often referred to as a “creator” or, in the case of *inter vivos* gifting, a “donor” or, in the case of dispositions upon death, an “**executor**”.
- several**. Separate, individual; contrasted with “**joint**”.
- solus*. An agreement for exclusive dealing. (Latin: alone.)
- specialty**. Deed.
- subrogation**. The principle that where an **insured** recovers an **indemnity** from the **insurer**, the insurer is allowed to “stand in the insured’s shoes” and prosecute all claims which the insured could otherwise have brought against the wrongdoer.
- sui juris*. Under no legal incapacity.
- sum insured/sum assured**. The amount available under the **policy** to indemnify the **insured** in respect of loss sustained by the occurrence of the **risk**.
- summary offence**. A minor criminal offence.
- summons**. A document issued from the office of a court of justice, calling upon the person to whom it is directed to attend before a judge or officer of the court.
- surrender**. Cancellation of a **policy** of insurance by an **insured** during its **term**.
- term**. The period of cover provided by the **policy**.
- term assurance**. Type of **policy** under which a sum is paid if death occurs within a fixed period.
- testator**. Person making a will.
- tort**. Civil wrong or injury (contrasted with *criminal* wrong).
- trespass**. Wrongful or unlawful intrusion against person or property.
- trust**. A **fiduciary** relationship in which one person is the holder of an **interest** in property but is subject to an equitable (see **equity**) obligation to use or keep that property for the benefit of another person or for some object or purpose.
- trust instrument**. Document by which property which is to be subject to a **trust** is vested in the **trustee** and the **beneficiary**.
- trustee**. The person in whom the **trust** property is vested.
- uberrimae fidei*. In the utmost good faith.
- ultra vires*. Beyond the powers — eg of the directors of a company; unauthorised.
- underwriter**. Insurer — usually applied to Lloyd’s underwriters.

venditioni exponas. Writ directing sheriff who held judgment debtor's goods and could not sell them at a reasonable price, to sell for best price available, however inadequate. (Latin: that you expose for sale.)

vicarious liability. Where the action of one person renders another person liable, eg the liability of an employer for the actions of his employee.

void/voidable. An act which is void is a legal nullity; it cannot be confirmed.

voir dire. Hearing by judge, during but apart from main trial, to settle a question from either party concerning any fact which has to be assumed for the purposes of the main trial (eg hostility, expertise or competence of witnesses, or voluntariness of confessions). Sometimes called "trial within a trial". (Anglo-French: to say truly.)

waiver. The act of renouncing, disclaiming, or abandoning a benefit or a **remedy**.

warranty. A promise or statement concerning the quality or characteristics of a thing; contrasted with "**condition**". In insurance a distinction is made between warranties as promises about a present fact or value and warranties as promises about a future course of action.

whole of life assurance. Type of life assurance under which a sum is paid on death.

writ. A document in the Queen's name and under the seal of the Crown, a court or an officer of the Crown, commanding the person to whom it is addressed to do or forbear from doing some act.

Key to Abbreviations

A	.....Atlantic Reporter (USA)
ABC	.....Australian Bankruptcy Cases
ABLR	.....Australian Business Law Review
AC	.....Law Reports, Appeal Cases
ACCC	.....Australian Competition and Consumer Commission
ACCG	.....Australian Consumer Credit Law Guide
ACL	.....Australian Current Law
ACLC	.....Australian Company Law Cases (1982 to date)
ACLD	.....Australian Current Law Digest
ACLR	.....Australian Company Law Reports
ACL Rep	.....Australian Current Law Reporter
A Crim R	.....Australian Criminal Reports
ACSR	.....Australian Corporations and Securities Reports
ACT	.....Australian Capital Territory
ACT	.....Australian Competition Tribunal
ACTR	.....Australian Capital Territory Reports
AGPS	.....Australian Government Publishing Service
AILR	.....Australian Industrial Law Review
AIPC	.....Australian Industrial and Intellectual Property Cases
ALJ	.....Australian Law Journal
ALJR	.....Australian Law Journal Reports
ALR	.....Argus Law Reports
ALR	.....Australian Law Reports
ALRC	.....Australian Law Reform Commission
ALT	.....Australian Law Times
AMPLJ	.....Australian Mining and Petroleum Law Journal
ANZ ConvR	.....Australian & New Zealand Conveyancing Reports
ANZ Insurance Cases	.....Australian & New Zealand Insurance Cases
AR (NSW)	.....Industrial Arbitration Reports of New South Wales
ASC	.....Australian Consumer Sales and Credit Reporter
ASC	.....Australian Securities Commission (until 1998)
ASIC	.....Australian Securities and Investments Commission (from 1998)
ASLR	.....Australian Securities Law Reporter
ATC	.....Australian Tax Cases
ATR	.....Australian Tax Review
ATPR	.....Australian Trade Practices Reports
ATPR (Com)	.....Australian Trade Practices Reports (Commission Decisions)
Ad & E	.....Adolphus and Ellis's Reports
Adel LR	.....Adelaide Law Review
All ER	.....All England Law Reports
All ER Rep	.....All England Law Reports Reprint
Alt LJ	.....Alternative Law Journal
Amb	.....Ambler's Reports
App Cas	.....Law Reports, Appeal Cases
Atk	.....Atkins' Reports
ATO	.....Australian Taxation Office
Aust Bar Rev	.....Australian Bar Review
Aust Jnl of Corp Law	.....Australian Journal of Corporate Law

Aust Torts Reports	Australian Torts Reports
AUSTRAC	Australian Transaction Reports and Analysis Centre
B & Ad	Barnewall and Adolphus' Reports
B & C	Barnewall and Cresswell's Reports
B & S	Best and Smith's Reports
BCC	British Company Law Cases
BCLC	Butterworths' Company Law Cases
BLB	Australian Banking and Finance Law Bulletin
BPR	Butterworths Property Reports
Beav	Beavan's Reports
Bing	Bingham's Reports
Burr	Burrow's Reports
C & P	Carrington and Payne's Reports
C & SLJ	Company and Securities Law Journal
CB	Common Bench Reports
CB(NS)	Common Bench Reports, New Series
CCL	Current Commercial Law
CCLJ	Competition and Consumer Law Journal
CDRJ	Commercial Dispute Resolution Journal
CJ	Chief Justice
CLC	Company Law Cases (1971-1981)
CLR	Commonwealth Law Reports
CMLR	Common Market Law Reports
C & SLR	Company and Securities Law Review
CTBR	Commonwealth Taxation Board of Review Decisions
CTBR (NS)	Commonwealth Taxation Board of Review Decisions (New Series)
Cal App	California Appellate Reports
Cal Rep	Californian Reporter
Camp	Campbell's Reports
Canb LR	Canberra Law Review
Car & K	Carrington & Kirwan's Reports
Ch	Law Reports, Chancery Division (1891 to date)
Ch App	Chancery Appeal Cases
Ch D	Law Reports, Chancery Division (1875-1890)
Cmnd	Command Papers
Co Rep	Coke's Reports
Com Cas	Commercial Cases
Commr of IR	Commissioner of Inland Revenue
Cr App R	Criminal Appeal Reports
Crim LJ	Criminal Law Journal
Cro Eliz	Croke's Reports (<i>temp</i> Elizabeth I)
Cro Jac	Croke's Reports (<i>temp</i> James I)
DCR (NSW)	District Court Reports (New South Wales)
DFC of T	Deputy Federal Commissioner of Taxation
DLR	Dominion Law Reports (Canada)
DPP	Director or Public Prosecutions
De G & J	De Gex and Jones's Reports
De GM & G	De Gex, Macnaghten and Gordon's Reports
E & B	Ellis and Blackburn's Reports
ER	English Reports
EU	European Union
East PC	East's Pleas of the Crown
Esp	Espinasse's Reports
Ex	Exchequer Reports
Exch	Exchequer Reports

Ex D	Law Reports, Exchequer Division
F(2d)	Federal Reporter, Second Series (USA)
FC of T	Federal Commissioner of Taxation
FCR	Federal Court Reports
FLC	Family Law Cases
FLR	Federal Law Reports
FRD	Federal Rules Decisions
FSR	Fleet Street Reports
F Supp	Federal Supplement (USA)
FTC	Federal Trade Commission (USA)
Fam LR	Family Law Reports
GATT	General Agreement on Tariffs and Trade
HKLR	Hong Kong Law Reports
HL	House of Lords
HL Cas	House of Lords Cases
HMSO	Her Majesty's Stationery Office
Hob	Hobart's Reports
Hy Bl	Henry Blackstone's Reports
ICSID	International Centre for Settlement of Investment Disputes
ILJ	Insurance Law Journal
IPLB	Australian Intellectual Property Law Bulletin
IPR	Intellectual Property Reports
IR	Industrial Reports
IR	Irish Reports
ITSA	Insolvency and Trustee Service Australia
Insolv LJ	Insolvency Law Journal
J	Judge or Justice
JBFLP	Journal of Banking and Finance — Law and Practice
JBL	Journal of Business Law (UK)
JCL	Journal of Contract Law
JJ	Judges or Justices (plural of J)
JLM	Journal of Law and Medicine
K & J	Kay and Johnson's Reports
KB	King's Bench Reports
King	Select Cases in Chancery, <i>temp</i> King
Knapp	Knapp's Appeal Cases
LGERA	Local Government and Environmental Reports of Australia
LJ	Law Institute Journal (Vic)
LJ, LJJ	Lord Justice, Lord Justices
LJ Ch	Law Journal, Chancery
LJCP	Law Journal, Common Pleas
LJ (NS)	New Law Journal Law Reports
LJQB	Law Journal, Queen's Bench
LMCLQ	Lloyd's Maritime and Commercial Law Quarterly
LQR	Law Quarterly Review
LRCCR	Law Reports, Crown Cases Reserved
LRCP	Law Reports, Common Pleas Cases
LRCPD	Law Reports, Common Pleas Division
LR Eq	Law Reports, Equity Cases
LR Exch	Law Reports, Exchequer
LRHL	Law Reports, English and Irish Appeals
LR Ir	Law Reports (Ireland)
LR (NSW)	Law Reports (New South Wales)
LRPC	Law Reports, Privy Council Appeals

LRQB	.....Law Reports, Queen's Bench
LSB	.....Law Society Bulletin (SA)
LSJ	.....Law Society Journal (NSW)
LSJS	.....Law Society Judgment Scheme (SA)
LT	.....Law Times Reports
LT (OS)	.....Law Times Reports (Old Series)
Legal SB	.....Legal Service Bulletin (now Alt LJ)
Legge	.....Legge's Supreme Court Cases (New South Wales)
LI LR	.....Lloyd's List Law Reports
Lloyd's Rep	.....Lloyd's Reports
M & S	.....Maule and Selwyn's Reports
M & W	.....Meeson and Welsby's Reports
MC	.....Magistrates Cases (Vic)
MLR	.....Modern Law Review
MR	.....Master of the Rolls
MULR	.....Melbourne University Law Review
MVR	.....Motor Vehicle Reports
Macph	.....Macpherson, Court of Session (Scotland), 3rd series
Mon LR	.....Monash University Law Review
Moo PC	.....Moore's Privy Council Cases
NADRAC	.....National Alternative Dispute Resolution Advisory Council
NE 2d	.....North Eastern Reporter, Second Series (USA)
NSWCA	.....New South Wales Court of Appeal decisions
NSW ConvR	.....New South Wales Conveyancing Cases
NSWJB	.....New South Wales Judgments Bulletin
NSWLR	.....New South Wales Law Reports
NSWLRC	.....New South Wales Law Reform Commission
NSWR	.....New South Wales Reports
NTLR	.....Northern Territory Law Reports
NTR	.....Northern Territory Reports
NY Rep	.....New York Reports
NYS	.....New York Supplement
NYS (2d)	.....New York Supplement, Second Series
NZBLC	.....New Zealand Business Law Cases
NZCLC	.....New Zealand Company Law Cases
NZLJ	.....New Zealand Law Journal
NZLR	.....New Zealand Law Reports
NZULR	.....New Zealand Universities Law Review
OR	.....Ontario Reports
P	.....President, NSW Court of Appeal
P	.....Law Reports, Probate, Divorce and Admiralty Division
P (2d)	.....Pacific Reporter, Second Series (USA)
P & CR	.....Property and Compensation Reports
PD	.....Law Reports, Probate, Divorce and Admiralty Division
QB	.....Queen's Bench Reports
QBD	.....Law Reports, Queen's Bench Division
QCA	.....Queensland Court of Appeal decisions
Q ConvR	.....Queensland Conveyancing Cases
QLR	.....Queensland Law Reporter
QLRC	.....Queensland Law Reform Commission
QLSJ	.....Queensland Law Society Journal
QSC	.....Queensland Supreme Court decisions
QUTLJ	.....Queensland University of Technology Law Journal
QWN	.....Queensland Weekly Notes
Qd R	.....Queensland Reports

Qld Lawyer	Queensland Lawyer
Qld Lawyer Reps	Queensland Lawyer Reports
R	Regina, Rex (the Crown)
RPC	Reports of Patent Cases
RTR	Road Traffic Reports (UK)
Reg	Registered number of application under the <i>Trade Practices Act</i> for authorisation, etc
SALR	South Australian Law Reports
SASR	South Australian State Reports
S Ct	United States Supreme Court Reporter
SE	South Eastern Reporter (USA)
SLR	Singapore Law Reports
SLT	Scots Law Times
SR (NSW)	State Reports (New South Wales)
SR (WA)	State Reports (Western Australia)
SW (2d)	South Western Reporter, Second Series (USA)
Salk	Salkeld's Reports, King's Bench
S (Ct of Sess)	Shaw, Court of Session Cases (Scotland) 1st series
Sim & St	Simons and Stuart's Reports
Sol Jo	Solicitors' Journal
St R Qd	Queensland State Reports
Syd LR	Sydney Law Review
TASSC	Supreme Court of Tasmania decisions
TBRD	Taxation Board of Review Decisions
TC	Tax Cases
TIA	Taxation in Australia
TLJ	Torts Law Journal
TLR	The Times Law Reports
TPA	Trade Practices Act
TPC	Trade Practices Cases
TPC	Trade Practices Commission (earlier name of ACCC)
TPLB	Australian and New Zealand Trade Practices Law Bulletin
TPLJ	Trade Practices Law Journal
Tas LR	Tasmanian Law Reports
Taunt	Taunton's Reports
Term Rep	Term Reports (Durnford and East)
Tort L Rev	Tort Law Review
Trade Reg Rep	Trade Regulation Reporter
ULR	University Law Review
UNICITRAL	United Nations Commission on International Trade Law
UNSWLJ	University of New South Wales Law Journal
UQLJ	University of Queensland Law Journal
US	United States Supreme Court Reports
U Tas LR	University of Tasmania Law Review
UWAL Rev	University of Western Australia Law Review
VLR	Victorian Law Reports
VR	Victorian Reports
VSC	Supreme Court of Victoria decisions
Ves Jun	Vesey Junior's Reports
Vic BN	Victorian Bar News
V ConvR	Victorian Conveyancing Cases
WALR	Western Australian Law Reports
WAR	Western Australian Reports
WASCA	Supreme Court of Western Australia decisions

WIPO	World Intellectual Property Organization
WLR	Weekly Law Reports
WN (NSW)	Weekly Notes (New South Wales)
WR	Weekly Reporter
WWR	Western Weekly Reports
Yale LJ	Yale Law Journal

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